

ETHIOPIA ECONOMIC UPDATE

Ensuring resilient recovery from COVID-19



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Contents

Acknowledgements	iv
Acronyms	v
Executive summary	vii
COVID-19 has severely affected Ethiopia, weakening its economic performance	vii
Further action is needed to ensure a resilient economic recovery in Ethiopia	ix
Context	1
Part I – Impacts of the COVID-19 crisis	5
1. Recent macroeconomic developments	7
Real sector	7
External sector	9
Monetary sector	12
Fiscal developments	17
Public debt developments	19
Macroeconomic outlook and risks	20
2. COVID-19 impacts on households and firms in Ethiopia	25
COVID-19 impact on employment	26
COVID-19 impact on income and livelihoods	28
COVID-19 impact on educational attainment of children	28
COVID-19 impact on firms	29
Economic recovery and expectations for poverty reduction	31
Part II – Special focus: ensuring a resilient recovery in Ethiopia	35
3. Policy options towards a resilient economic recovery in Ethiopia	37
Containing the pandemic and protecting health	38
Protecting livelihoods and human capital	40
Food security	40
Social assistance	42
Education	43
Supporting jobs and firms	44
Ensuring access to finance and financial sector stability	49
Coordinating the macroeconomic response	51
Linking the response to a sustainable recovery	52
Mapping the way forward	54
Bibliography	56

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Acronyms

AfDB	African Development Bank
CBE	Commercial Bank of Ethiopia
CERC	Contingent Emergency Response Component
ComBAT	Community Mobilization Activities and Testing
COVID	Coronavirus Disease
DBE	Development Bank of Ethiopia
DP	Development Partner
DSA	Debt Sustainability Analysis
ECF	Extended Credit Facility
EFF	Extended Fund Facility
EU	European Union
FDI	Foreign Direct Investment
FY	Fiscal Year (refers to the Ethiopian Fiscal Year, ending in July 7)
GDP	Gross Domestic Product
GEQIP-E	General Education Quality Improvement Program for Equity
GoE	Government of Ethiopia
GPE	Global Partnership for Education
GTP	Growth and Transformation Plan
HFPS-F	High-Frequency Phone Survey of Firms
HFPS-HH	High-Frequency Phone Survey of Households
IMF	International Monetary Fund
IP	Industrial Park
JCC	Job Creation Commission
LSMS	Living Standards Measurement Study
MoSHE	Ministry of Science and Higher Education
NBE	National Bank of Ethiopia
NERP	National Emergency Response Plan
NGO	Non-Governmental Organization
PES	Public Employment Services
PHEOC	Public Health Emergency Operation Center
POE	Point of Entry
PPE	Personal Protective Equipment
PPG	Public and Publicly Guaranteed
PPP	Public-Private Partnership
PSNP	Productive Safety Net Program
REER	Real Effective Exchange Rate
REERI	Real Effective Exchange Rate Index
SME	Small and Medium Enterprises
SOE	State-Owned Enterprise
TVET	Technical and Vocational Education and Training
UPSNP	Urban Productive Safety Net Program
US	United States
VAT	Value-Added Tax
WB	World Bank
WTO	World Trade Organization





Executive Summary

COVID-19 has severely affected Ethiopia, weakening its economic performance

Ethiopia has experienced a collapse in external demand since April 2020 due to COVID-19. While merchandise exports, excluding gold, increased by 5.8 percent overall in FY20, they declined by 4.1 percent during July-December 2020 (year-on-year). Exports of garments, textiles, and fruits and vegetables have been particularly hit since the onset of the pandemic. Both exports and imports of services, dominated by air transport, recorded negative growth in FY20. Remittances dropped by 10 percent in FY20, although they have rebounded during the first half of FY21. Merchandise imports, which were already on decline prior to COVID-19, dropped by 8 percent in FY20, contributing to the narrowing of the current account balance, estimated at about 4 percent of GDP. Meanwhile, foreign direct investment has been severely hit, with inflows declining by 20 percent in FY20, contributing to weakening reserve levels. Despite the severe impacts, Ethiopia grew at 6.1 percent in FY20, as the impact of the COVID-19 pandemic took place largely in the final quarter of the fiscal year.

Phone survey data suggests that both firm revenue and household income are significantly depressed, which points to weakening domestic demand. While most companies that had to temporarily close their business have reopened since April, the reported median monthly sales revenue in October remained at just a third of the pre-COVID-19 level. Although the share of formal firms in Addis Ababa that fired workers has remained low—presumably due to the provision in State of Emergency Proclamation that did not allow dismissals—it has consistently outnumbered



the share of firms with new hires. At the household level, the proportion of respondents reporting that incomes were either reduced or had completely disappeared due to the pandemic declined from about 55 percent in April to 26 percent in October but remains a concern.

Persistently high inflation adds to the affordability challenges faced by households. While easing slightly during the first half of FY21, at 19.2 percent in January 2021 inflation remained high, driven by high food prices (cereals and vegetables in particular). It is unclear whether the COVID-19 crisis has added to pre-existing inflationary trends. Recent surveys suggest the food security situation is not significantly worse than prior to the pandemic, at least in terms of food availability, although depressed incomes due to the crisis are likely to exacerbate the food affordability challenges the poorer households are facing.

Faster currency depreciation has only resulted in a reduction in overvaluation in recent months, as inflation started to ease. During FY20, the birr depreciated by about 21 percent in nominal terms against the U.S. dollar (compared to 6 percent in previous years). However, by June 2020, the real effective exchange rate index (REERI) had appreciated by about 1 percent relative to June 2019, due to the large inflation differential vis-à-vis trading partners. As inflation started to ease in the fall 2020, it is estimated that the real exchange rate has been depreciating again during the first half of FY21.

The monetary policy stance of the NBE has loosened in response to challenges. Monetary policy, which had been tightening since FY18, started to loosen in February 2020, as the NBE injected funding into commercial banks, which had been experiencing liquidity challenges since November 2019, and expanded lending to the government as part of the response to the COVID-19 pandemic. As a result, average growth in reserve money increased to about 25 percent in the second half of FY20 and surged further to 37 percent during the first half of FY21 (vis-à-vis the same period of the previous year). Meanwhile, growth in broad money supply picked up to 22 percent during the first half of FY21, and is increasingly driven by credit to the private sector. Preliminary data for first half of FY21 shows a 5 percent decrease in the collection of payments by commercial banks, which suggests some firms and households, impacted by the COVID-19 crisis, may be struggling to repay their loans.

On the fiscal side, the deficit expanded but more modestly than expected. Revenue mobilization at the federal level is estimated to have declined by the equivalent of 0.5 percent of GDP in FY20, with domestic direct and indirect tax collection impacted by COVID-19, which was partly compensated by an improvement in trade tax collections related to the phasing out of exemptions. A series of tax deferrals introduced by authorities for the last quarter of FY20 to support firms facing liquidity constraints is unlikely to have had a major bearing in the revenue shortfall. Preliminary data suggests despite the surge in healthcare spending in response to the pandemic, expenditure execution fell short from budgeted amounts. Overall, the federal government fiscal deficit is estimated to have widened from 2.5 percent of GDP in FY19 to 2.8 percent of GDP in FY20. The public debt is not estimated to have increased in FY20, although Ethiopia remains at high-risk of debt distress due to high value of the debt to exports and debt service to exports ratios. In order to bring the risk of debt distress to moderate, as required under the IMF program, authorities have requested debt treatment under the G-20 Common Framework.

In Ethiopia, the adverse impact of the COVID-19 pandemic on economic activity is expected to continue in FY21, prior to experiencing a rebound in FY22 and beyond. While the State of Emergency was lifted in September, domestic demand is expected to remain depressed due to the impacts of the pandemic, with growth slowing to around 2 percent in FY21. Recovery in exports



and foreign direct investment is expected to remain muted in FY21, hindered by the impacts of the pandemic on external demand as well as domestic constraints, including foreign exchange shortages. A continued drop in imports could contribute to the further narrowing of the current account deficit. Due to continued expenditure needs related to the COVID-19 pandemic, the fiscal deficit is expected to remain around 3 percent of GDP in FY21, prior to falling below 2 percent in subsequent years as revenue collection recovers and spending needs decline once the pandemic recedes. Inflation is forecasted to remain elevated in FY21 then fall to single digits by FY22 as tighter monetary policy is implemented. As key macroeconomic and structural reforms are fully implemented by 2022, foreign direct investment, exports, and economic growth are expected to strengthen in the medium term.

While Ethiopia has made strong progress on poverty reduction, vulnerability has remained high and is likely exacerbated by the pandemic. A reduction in aggregate demand will affect the self-employed, with 44 percent of urban households deriving their main income through self-employment. Although rural areas were in principle expected to be less affected by the COVID-19 crisis, around one-third of households who relied on farming for their livelihoods in June reported a reduction in income over the past month. Against a backdrop of a large vulnerable population, a shock across the country that reduces household consumption by 10 percent would, all else being equal, raise the poverty rate by 6 percentage points. This would bring about 6.5 million people into poverty, reversing all the progress made in poverty reduction between 2011 and 2016. Government initiatives to increase safety net benefits and facilitate credit to small businesses, many of them women-headed, are expected to help mitigate these risks.

Downside risks to this outlook loom large due to internal conflict and the uncertainty surrounding the COVID-19 crisis. If there was a resurgence in COVID-19 cases and a need to reinstate restrictive contention measures, production and consumption would be hindered further. Under that scenario, domestic economic activity and demand would be depressed much more dramatically, likely bringing Ethiopia into recession and increasing financing needs. Should the confrontations in Tigray and other regions increase, political and economic stability in Ethiopia and the region could be at risk. Foreign investment decisions could also be put on standby until after the national elections, which are expected to take place in June 2021. Finally, the locust infestation, which has so far affected mainly pastoral areas, could spread and damage crop production.

Further action is needed to ensure a resilient economic recovery in Ethiopia

Measures to containing the pandemic, such as those authorities swiftly introduced, will remain key towards minimizing damage and preventing a second wave of infections. Since March 2020, Ethiopia has implemented surveillance at borders, conducted contact tracing, established designated quarantine facilities, ensured the supply of drugs and protective equipment, and embarked in several communication efforts to raise awareness on how to deal with the virus. A multisectoral COVID-19 National Emergency Response Plan has also been adopted to ensure efforts to fight the crisis are comprehensive and well-coordinated. Ethiopia has already taken significant steps to procure and deploy the COVID-19 vaccine, including by participating in the COVAX initiative and conducting a readiness assessment. It would be important to address as soon as possible the gaps identified by the assessment in terms of adopting the needed regulation for the procurement, as well as standard operation procedures for the deployment, performance monitoring, and communication and advocacy. Going forward, it would be also crucial to continue strengthening healthcare systems, including those relating to infectious disease detection and response.



It will be equally important to shield households, whom are facing loss of income. First, there is a need to continue updating safety net benefits to address the loss in purchasing power caused by inflation and to expand coverage and facilitate registration for new beneficiaries, as already planned by the authorities with the support of development partners. As the COVID-19 crisis continues to unfold, it will be important to continue strengthening the successful measures adopted so far to prevent food supply disruptions and price spikes. In addition, going forward, further development of distance learning platforms shall be a priority. All these measures are expected to help minimize human capital losses and promote a recovery in domestic consumption.

Measures aimed at protecting firms may need to be rethought to optimize resources while supporting those most affected. So far, direct support to firms in Ethiopia has been instrumented mainly through temporary tax deferrals and measures to support exporters. Overall, adopted measures are likely to have benefited formal firms almost exclusively. Going forward, support shall focus on supporting Small and Medium Enterprises (SMEs), including by leveraging and boosting existing programs. Support to firms may be articulated through eased access to credit and working capital, as tax deferrals and wage subsidies may not be enough to shield jobs from a protracted crisis. In this regard, continuation of the forbearance measures introduced in the financial sector will need to be coupled with the redesigning of liquidity and loan provision schemes in a way that ensures that funding trickles down to customers.

Finally, the Government of Ethiopia is to be commended for having kept advancing its Homegrown Economic Reform Agenda despite COVID-19. Implementing some complementary reforms will be key to ensuring a resilient recovery in the new COVID-19 normal. First, to take full advantage of the ambitious telecom sector reforms, it will be important to implement the new Proclamation on e-Transactions and to strengthen the regulatory framework to facilitate digital financial services. Second, to make the most of the reconfiguration of global value chains, Ethiopian authorities shall revisit existing investment incentives, phasing out tax holidays and emphasizing machinery acquisition and worker training, while preparing as well towards WTO accession. Third, at this juncture of lower international oil prices Ethiopia may consider revisiting fuel subsidies to reap savings that can be used in needed COVID-19 response spending, while promoting green recovery. Policy options are discussed in more detail in section 3, and summarized in Table 2 at the end of the report.





Context

Despite the swift response by authorities, the COVID-19 pandemic has found its way into Ethiopia. After identification of the first case in mid-March, 2020, by March 1, 2021 the number of confirmed COVID-19 cases had reached 160 thousand, and more than two thousand deaths had been recorded. Containing transmission of the virus is of utmost importance, particularly in a country that ranks second to last in Africa in terms of hospital beds (at 0.3 per thousand people). While the number of cases in Ethiopia peaked in August 2020, the fact that the positive rate for the tests conducted remains at over 10 percent suggests infections are likely to be underreported (Figure 1). Like pretty much elsewhere in the world, the pandemic seems far from over, and a sustained effort towards containment remains necessary.

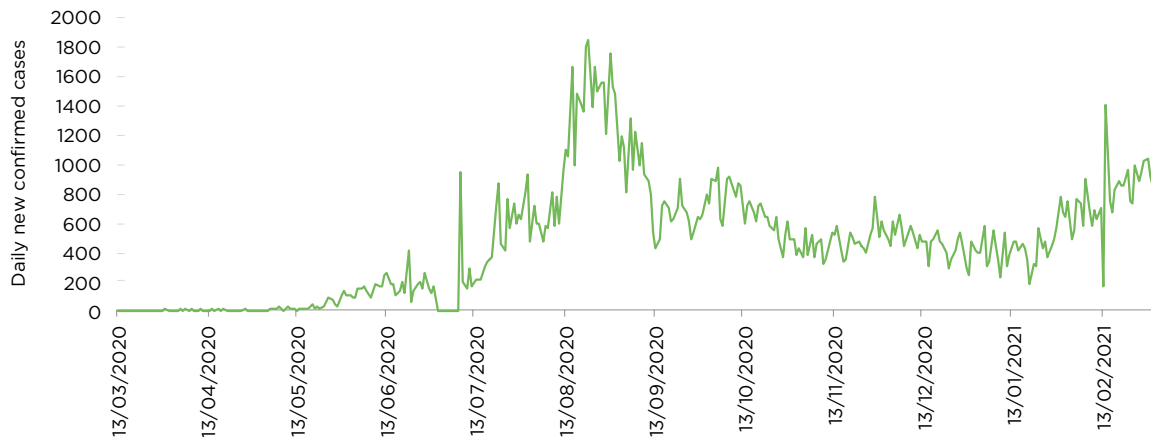
The Government has put in place a range of measures to mitigate the economic impact of the COVID-19 pandemic while aiming to contain transmission. Right after the first few cases of COVID-19 were detected, the Government of Ethiopia prepared a comprehensive and well-coordinated COVID-19 National Emergency Response Plan (NERP—see section 3.1 in Part II for further detail). To mitigate impacts on people and firms, authorities announced several economic measures, including additional expenditure on healthcare, provision of emergency food to the vulnerable, tax and social security payment deferrals, and liquidity injections and extension of forbearance measures in the financial sector. The Government received support from several development partners for the implementation of NERP, including US\$83 million from the World Bank for the Ethiopia COVID-19 Emergency Response Project, US\$250 million supplemental financing from the World Bank, and US\$411 million Emergency Assistance from the IMF. Other development partners, including the



African Development Bank (AfDB), European Union (EU), and France, also provided emergency support in the aftermath of the outbreak.

Figure 1. Confirmed COVID-19 cases in Ethiopia are rising again

Daily new confirmed COVID-19 cases in Ethiopia



Source: COVID-19 Data Repository by the Center for Systems Science and Engineering at Johns Hopkins University.

Before the COVID-19 crisis hit, the government was implementing its Home-Grown Economic Reform Program, launched in September 2019. This economic reform program builds on the objectives of the Growth and Transformation Plan (GTP II) to foster private sector development. It complements the structural reforms initiated in June 2018, when Prime Minister Abiy Ahmed took office, with measures aimed at tackling macroeconomic imbalances and with a set of sectoral reforms. Government reform initiatives are supported by development partners, including the World Bank (through the Growth and Competitiveness Development Policy Financing budget support operations) and the International Monetary Fund (IMF) (through a US\$ 2.9 billion program approved in December 2019). The government's objective is to sustain the growth momentum of the past decade by shifting the development strategy from a public-sector-dominated to a private-sector-oriented model, with the aim of creating jobs for its young and growing population, with approximately 2 million new entrants joining the labor market each year.

Despite the impact of the COVID-19 pandemic, authorities have continued making progress in the implementation of this ambitious reform program. Following the introduction of a Telecom Proclamation in 2019, the move toward liberalizing the telecom sector has continued with the establishment of the Ethiopian Communications Authority, the sector regulator, which has issued a Request for Proposals for two new telecom licenses. The initiative to establish a Public-Private Partnership (PPP) framework has also progressed well. The government is also making good progress on other reform initiatives, including streamlining business licensing regulations, preparing the regulation governing State-Owned Enterprises (SOEs), opening-up the logistics sector for competition, and adopting new investment and privatization laws.

This 8th Edition of the Ethiopia Economic Update discusses COVID-19 impacts on Ethiopia and policy responses towards a full recovery. Part I starts by assessing recent macroeconomic developments and the outlook, with emphasis on the effects of COVID-19 on the external sector, monetary and fiscal policies, and government revenue collection. It also presents evidence of



microeconomic-level impacts of COVID-19 on households and firms, drawing from high-frequency phone surveys conducted by the World Bank Group in the months following the outbreak. Part II summarizes the policy response adopted by authorities so far on different key areas (containing the pandemic, protecting livelihoods, supporting firms and jobs, ensuring access to finance...) and, drawing from existing sectoral notes and the ongoing policy dialogue, proposes additional response and recovery measures to be adopted going forward.



PART 1

Impacts of the COVID-19 crisis





1

Recent macroeconomic developments

Real sector

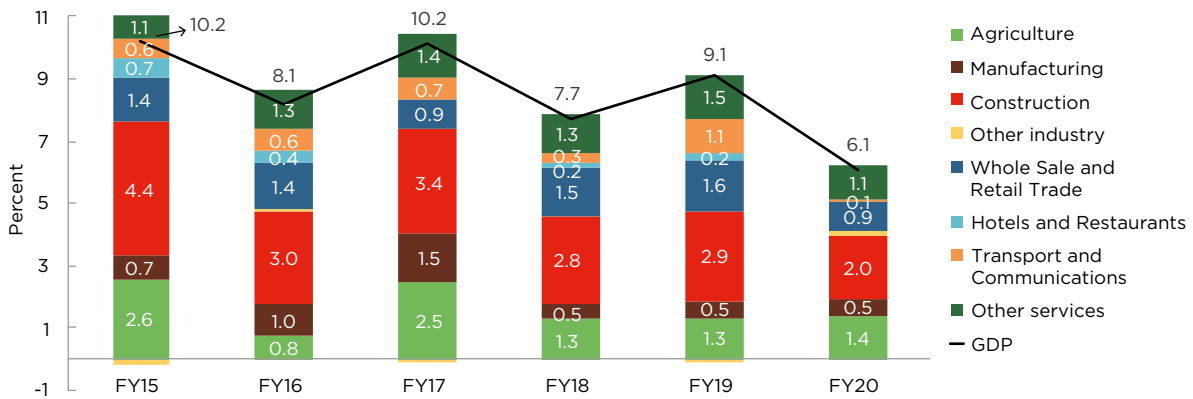
Official estimates show a robust GDP growth in FY20, likely due to the pre-COVID-19 pandemic. While growth went down to 6.1 percent in FY20 from 9.1 percent in FY19, it was significantly above expectations. Agriculture was not affected by the pandemic with its contribution to growth slightly improving (Figure 2). Meanwhile, growth in industry and services slowed down to single digits.

Agriculture growth was robust thanks to an abundant harvest. During the main harvest season of FY20, which run from September through December 2019, grain crop production showed an increase of 6.2 percent, compared to the 3.1 percent growth in FY19. Pulses were the only crop type to show a marginal decline in growth rate (0.2 percent), while both cereals and oilseeds showed strong growth rates of about 7 percent. The growth of livestock subsector was reduced by half to 3.3 percent compared to 6 percent in FY19 while forestry and fishing subsectors registered nearly the same growth.

The COVID-19 pandemic exerted additional pressures on industrial production, which was already marred by persistent foreign exchange shortages and unreliable electricity supply. Growth in industrial production dropped to 9.6 percent in FY20 continuing a downward trend from as high as nearly 21 percent in FY17. While electricity production increased by 20 percent during the fiscal year, reliability in supply remains an issue, and foreign exchange shortages have reportedly persisted. The waiting time for foreign exchange in private commercial banks has been found to range between



Figure 2. The contribution of services and construction to growth declined in FY20
Contribution to GDP growth, in %

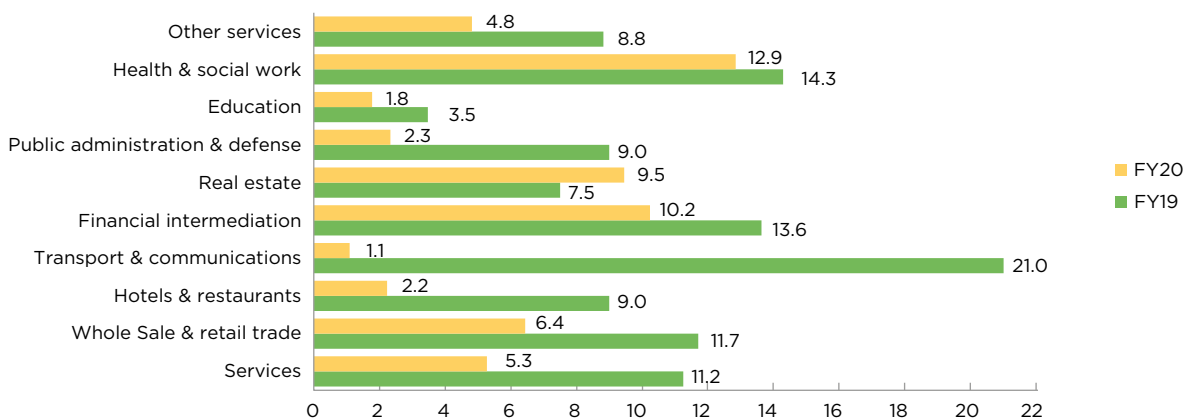


Source: Planning and Development Commission of Ethiopia.

4-12 months for essential imports and up to 3 years for non-essential imports (Lloyd and Teshome, 2018). That manufacturing just registered a slight drop in its growth rate was unexpected, given the reported disruptions in factories faced since March due to COVID-19. According to a recent survey on COVID-19 impacts, 42 percent of surveyed industrial firms in Addis Ababa temporarily closed and halted production in March and early April (Abebe et al., 2020). Although growth in construction dropped compared to the high growth rates of the preceding years, it remained relatively strong at about 10 percent. The resumption of manufacturing and construction activities toward the end of the fiscal year, with businesses implementing hygiene and social distancing measures, might have contributed to limiting the impact of the pandemic on growth figures for FY20.

The service sector was the most negatively affected by the COVID-19 pandemic, with its growth rate halving compared to the preceding fiscal year. The growth slowdown was more pronounced in transport & communication, hotels & restaurants, wholesale & retail trade and public administration & defense (Figure 3). Suspension and cancellation of flights by Ethiopian Airlines and restrictions

Figure 3. Service sector was the most affected by COVID-19
Growth in service sector, in %



Source: Planning and Development Commission of Ethiopia.



imposed on transport services following the State of Emergency declaration in early April contributed to the significant slowdown in growth in the transport & communication subsector. Restrictions on global mobility following the pandemic severely impacted tourism and hotel businesses. The Addis Ababa Hotels Owners Association disclosed that about 88 percent of its members were forced to partially or fully close during the pandemic as occupancy rates dropped. While there was no national lockdown in Ethiopia, restrictions imposed on movements of goods and people during the State of Emergency have likely impacted wholesale and retail trade activities.

External sector

The current account balance improved from 5.1 percent of GDP in FY19 to about 4 percent in FY20, as the drop in service exports and remittances caused by COVID-19 was offset by a sharper decline in imports. Despite a significant slowdown in export items (including flowers and textiles) since the onset of the pandemic, merchandise exports showed a slight rebound in FY20. Meanwhile, service exports, which performed strongly over the past couple of years, and remittances collapsed due to the COVID-19 crisis. As the contraction of imports of goods and services has been more severe than the drop in exports, the current account deficit narrowed.

Merchandise exports have been adversely affected by the COVID-19 pandemic. Although total exports excluding gold¹ increased by 5.8 percent overall in FY20, they just expanded by 1.6 during April-June 2020 (year-on-year). During July-December 2020, merchandise exports declined by 4.1 percent (year-on-year). Exports of garments, textiles, and fruits and vegetables have been especially hit since the onset of the pandemic (Figure 4). While coffee exports were resilient initially thanks to an increased production and slightly higher international prices, they contracted during the first half of FY21. Exceptional flower export growth has also withered. The performance of pulse exports remains underwhelming, while oilseeds have recovered after dropping in FY20.

As public investment continued to be restrained and foreign exchange shortages persisted, merchandise imports dropped by about 8 percent in FY20. Imports of capital goods (including heavy road motor vehicles and aircrafts) and consumer durables (mainly cars) continued to drive the fall in imports, while imports of cereals and fertilizer increased as they are given priority access in the foreign exchange allocation. Fuel imports also dropped in value, reflecting the fall in international prices of crude oil, while imports volume increased by 6.4 percent during July 2019-March 2020, domestic retail fuel prices, which are set by the government, were not adjusted down despite the drop in international prices, and remain higher than their levels of the preceding year.² Although imports were declining even before the pandemic, COVID-19 may have exacerbated the rate of decline for some import items including heavy road motor vehicles, cars, and pharmaceuticals (Figure 5).

Service exports, which performed well in the preceding fiscal years, slowed down in FY20. Service exports started to slow even before the onset of the COVID-19 pandemic, dropping by 5.4 percent during the first half of FY20. Significant declines in export earnings from travel services (related to tourism) and government services (related to the activities of embassies and international organizations) contributed to the slowdown. This is despite continued good performance from transport services,

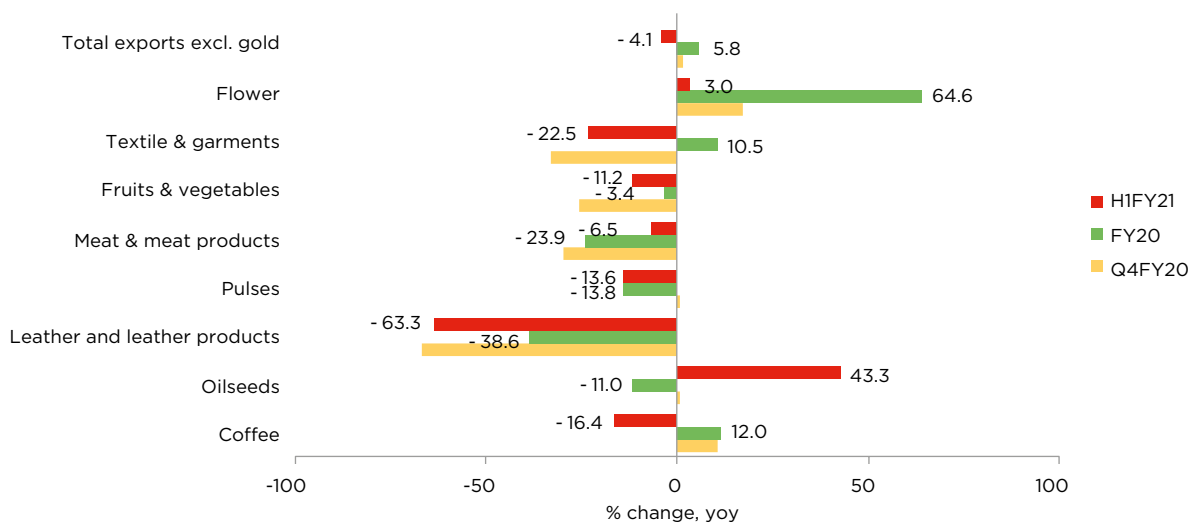
1 When gold (which constitutes gold purchases by the NBE, largely from artisan miners) is included, the growth in total exports in FY20 is 12 percent, as NBE has managed to buy a larger amount of gold during the fiscal year by increasing its purchase price beyond the international price.

2 When international prices of oil go down, the government usually does not adjust retail prices downward and instead accumulates the resulting surplus in the Fuel Stabilization Fund. While information on the Fuel Stabilization Fund is scanty, it seems that the Fund could be a significant source of public resources in some instances. For examples, in FY17, the government was able to mobilize about 12 billion birr from this Fund when it approved a supplementary budget amounting to about 18 billion birr.



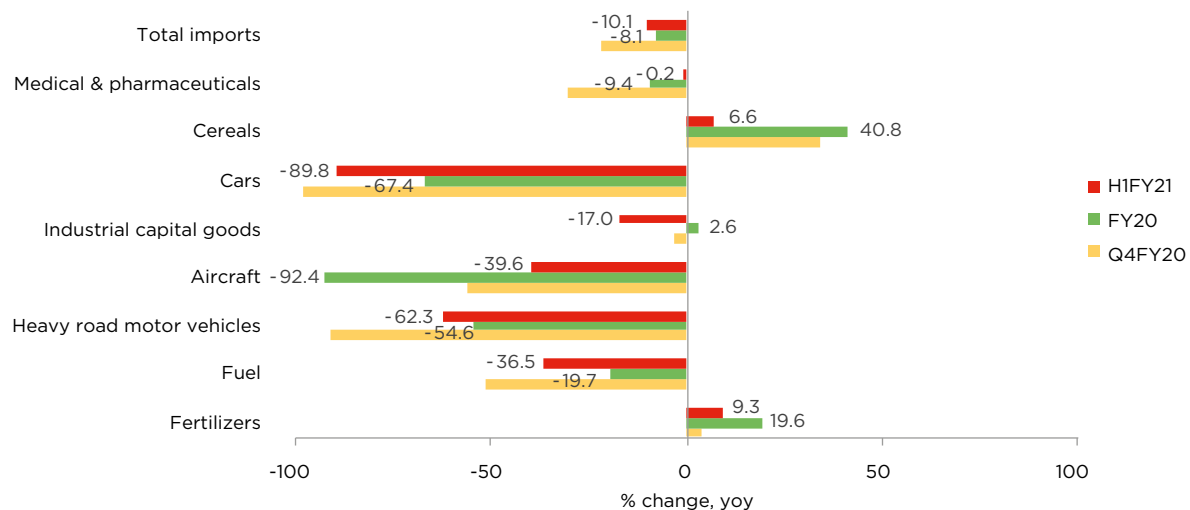
which account for more than two-thirds of total service exports. In particular, Ethiopian Airlines reported US\$3.3 billion in revenue in FY20, or 82 percent of their target, despite the hit of the pandemic during the last four months of the fiscal year.³ With the onset of the COVID-19 pandemic, performance of travel services worsened, and transport services also weakened, thereby leading to a further decline in overall service exports, which fell by 6.1 percent in FY20. Nonetheless, the net service balance improved, as service imports contracted by an estimate of 11.5 percent in FY20.

Figure 4. Exports were hit by the COVID-19 crisis in the last quarter of FY20 and first half of FY21
Main export items, year-on-year % change



Source: NBE.

Figure 5. Imports were contracting even before COVID-19 hit
Main import items, year-on-year % change



Source: NBE.

³ "Ethiopian Airlines Group generates US\$3.3B revenue". Further Africa. October 1, 2020.



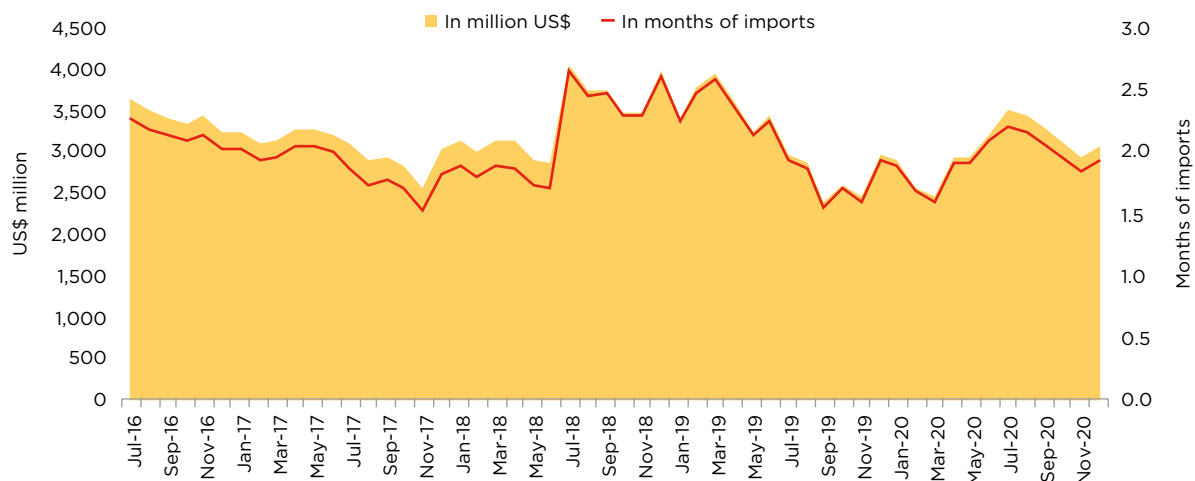
Private transfers continued their downward trend in FY20, while official transfers also decreased after a big surge last year. Private transfers declined by about 6 percent in FY20, falling from 6.2 percent of GDP in FY19 to 5.3 percent in FY20. Remittances, which account for more than 85 percent of private transfers (the remaining 15 percent constitutes transfers through NGOs), went down by 10 percent in FY20, impacted by COVID-19. Preliminary data for June-December 2020 suggests a rebound in private transfers (17.1 percent, yoy).

The COVID-19 pandemic has surely contributed to the slump in foreign direct investment (FDI), as it also delayed the privatization plans of the government. Inflow of FDI, which was already on a downward trend, fell further to 2.3 percent of GDP, with some investment decisions possibly delayed due to uncertainty surrounding the general elections (postponed from their original schedule of August 2020) as well as the COVID-19 pandemic.

As capital inflows through private channels (including FDI) slowed, impacted by the pandemic, foreign exchange buffers remain limited. Net capital inflows through the public sector improved slightly from 1.5 percent of GDP in FY19 to 1.6 percent in FY20, as an increase in official capital inflows through the central government (presumably related to a surge in COVID-19-related assistance) offset restrained foreign borrowing by SOEs. Gross foreign exchange reserves of the National Bank of Ethiopia (NBE) increased from US\$ 3.0 billion in December 2019 to US\$ 3.2 billion at the end of June 2020, but went down again to US\$ 3.0 billion by December 2020 (Figure 6). Relatively lesser inflow of financing from development partners (from an exceptionally high level in FY19) and of forex surrendering requirements by commercial banks (as remittances and service exports were hit by the COVID-19) are presumably the drivers of the decline in reserves in recent months. At around two months of import coverage, gross foreign exchange reserves remain thin.

The NBE started to allow a much faster rate of depreciation of the Ethiopian birr in FY20. During FY20, the birr depreciated by about 21 percent in nominal terms against the U.S. dollar (compared to 6 percent in previous years). As the NBE accelerated the rate of depreciation of the birr starting from mid-October 2019, the real exchange rate depreciated in the last quarter of 2019 for the first time since the 2017 devaluation (Figure 7). However, the real effective exchange rate index (REERI) started to appreciate again in February and March 2020, as the pace of nominal depreciation slowed

Figure 6. Reserves have recovered in recent months supported by lower oil prices and donor inflows
Gross foreign exchange reserves

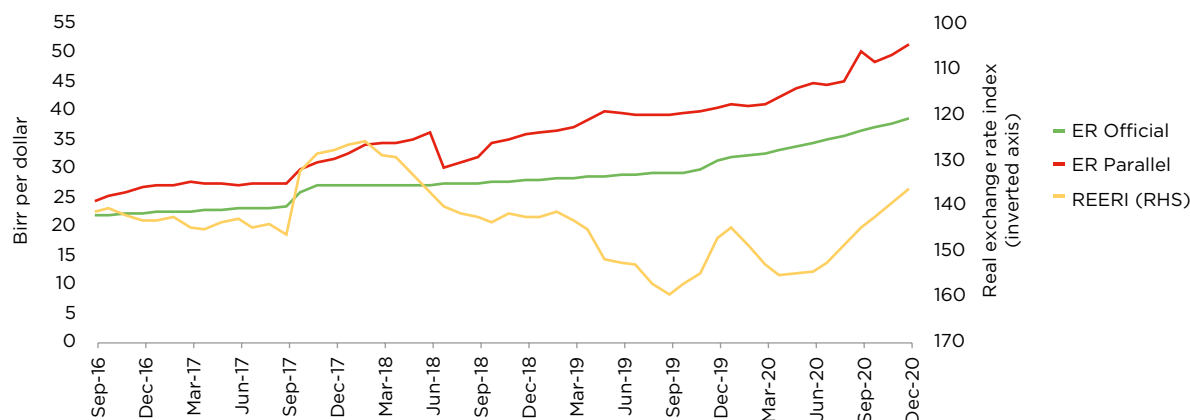


Source: NBE.



down against the backdrop of high inflation differentials with trading partners, driven by food and electricity price hikes, “eating away” the potential gains from faster nominal depreciation. By June 2020, the REERI had appreciated by about 1 percent relative to June 2019. As inflation started to ease in the fall 2020, the real exchange rate has depreciated significantly during the first half of FY21.

Figure 7. The birr has depreciated in both nominal and real terms during the first half of FY21
Nominal and Real Exchange Rates of birr



Source: NBE and World Bank.

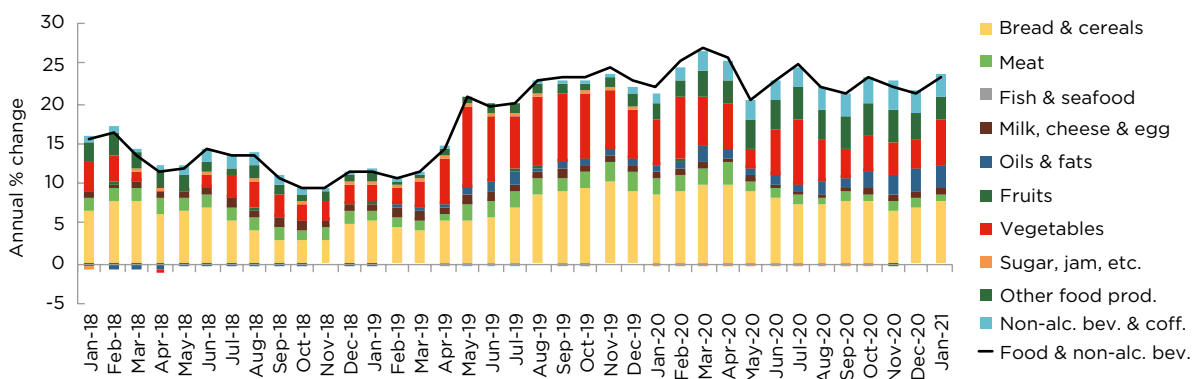
Monetary sector

Inflation has remained high, with headline inflation largely hovering around 20 percent in the first months of FY21. Headline inflation peaked at 22.3 percent in July 2020, prior to easing in recent months, while staying at 19.2 percent in January 2021. Both food and non-food inflation have remained elevated, although the contribution of food inflation has been more pronounced. Supply shortages due to extended delays in the import of wheat by the government are likely behind the increase in prices of cereals and bread, while drops in production and disruptions in logistics and supply chains are probably the major factors for the rise in prices of vegetables. After the revised excise tax proclamation came into effect in March 2020, the contribution of non-alcoholic beverages and coffee to food inflation has also increased (Figure 8, left panel). Meanwhile, the category of “housing, water, electricity, gas and other fuels” has been the main driver of non-food inflation, probably reflecting rent increases in Addis and other towns and tariff increases for utilities (Figure 8, right panel). It is unclear whether the impact of COVID-19 is adding (via supply disruptions) or subtracting (via weaker demand) to the inflationary pressures.

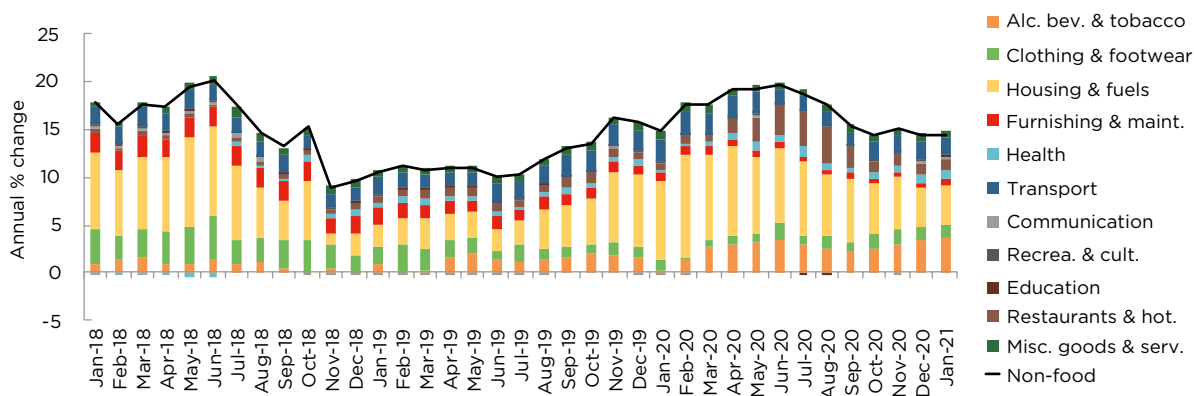
Despite the rising levels of inflation, interest rates have remained largely unchanged. The minimum interest rate commercial banks pay to depositors remains at 7 percent, well below the average rate of inflation and unchanged since October 2017. In its recently launched Home-Grown Economic Reform Program, the government has acknowledged that controlled interest rates and other financial repression policies to facilitate public sector investment have limited private sector access to credit and have contributed to the prevailing macroeconomic imbalances, thus expressing readiness to gradually phase out these policies. The lifting of the “27 percent rule” in December 2019 is one measure along these lines. The Ministry of Finance started issuing T-bills at competitive rates in December 2019 as part of the effort to develop well-functioning financial markets (Box 1).



Figure 8. Cereals, vegetables, and energy and housing prices have been driving inflation
Drivers of food inflation



Drivers of non-food inflation



Source: CSA.

BOX 1

Making T-bills Auctions More Competitive

Despite their existence for a relatively long time, the T-bills auctions remained uncompetitive. The government started selling T-bills in 1995. While the number of participants in the T-bills auctions has always been limited, it has fallen significantly over the past five years. Commercial banks have not participated in the auctions for over five years because of restrictions introduced by the NBE. T-bills sales over the past few years have been targeted to captive buyers that are state-owned entities, mainly pension funds and the Development Bank of Ethiopia (DBE). As a result, the yields on T-bills have been extremely low, remaining below 2 percent for over five years (see left panel in the figure). At the end of FY19, out of the total stock of outstanding T-bills, the pension funds (for both public and private sector employees) accounted for 77 percent, while DBE's share was 22 percent. T-bills constituted about 38 percent of the government's stock of debt.

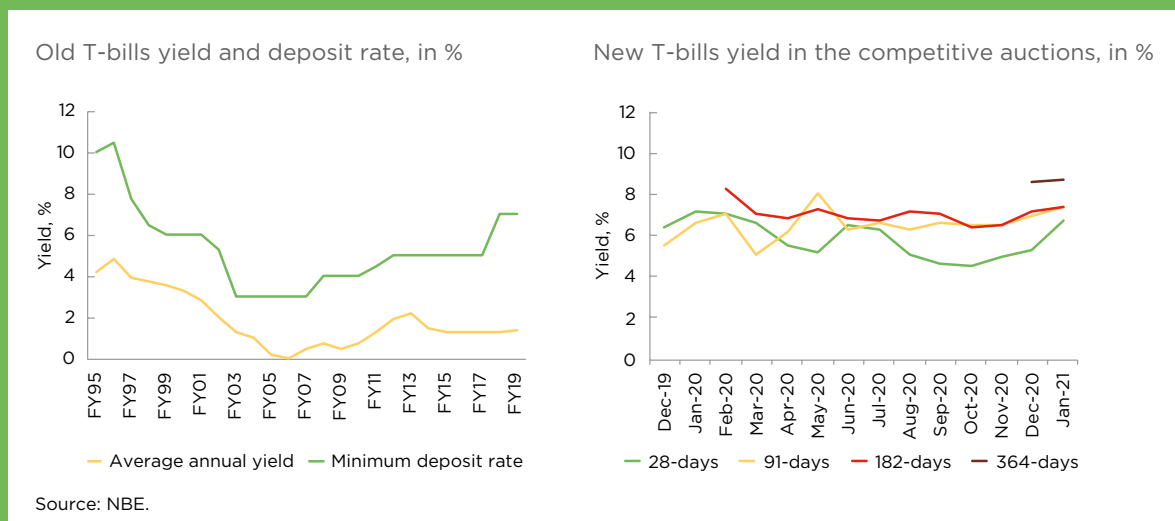


BOX 1

Making T-bills Auctions More Competitive (continued)

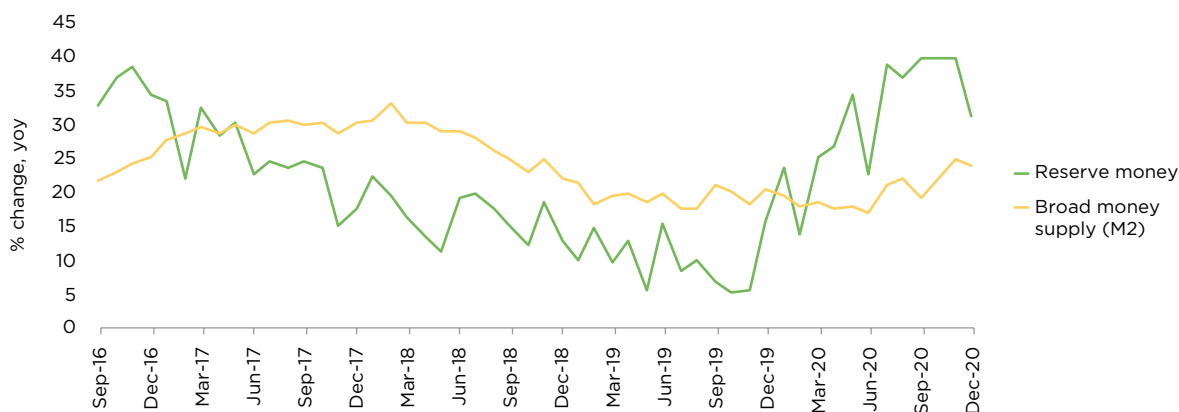
As part of the Home-Grown Reform Program, the government intends to make the T-bills auctions more competitive by again allowing private sector actors to bid. Since December 2019, T-bills auctions have been conducted twice a month. After these competitive auctions were introduced, the previous stock of T-bills held by the DBE and the pension funds was converted into two-year maturity Treasury Notes. Initially, 28-days and 91-days bills were offered in the competitive auctions, while 182-days and 364-days bills were included starting in February and November 2020, respectively. The amount of T-bills offered for auction has significantly increased over the past months, going up from a mere 1 billion birr in December 2019 to 35 billion birr in January 2021. Of the total bills offered for auction in January 2021, about 52 percent were 182-days bills, 26 percent 91-days bills, 19 percent 364-days bills and the remaining 3 percent 28-days bills. The 28-days and the 91-days bills were the most demanded, with the amount of bids received being consistently higher than the amount offered, except for January 2021, when demand was below supply for the 91-days bills. Demand for the 182-days bills was sluggish and below supply during the initial months, although it increased significantly and exceeded supply since July 2020 before slipping below supply again since November. The demand for the 364-days bills has remained below supply since its introduction on November. T-bills yields have risen significantly since the start of the competitive auctions, with the average yield reaching 7.1 percent in January 2021 (see the right panel in the figure). Since the NBE lifted previously existing restrictions, commercial banks have been participating in the auctions, although the higher returns from lending coupled with some liquidity challenges have often limited their uptake of T-bills.

A recent NBE directive instructing insurance companies to invest at least 40 percent of their assets in T-bills could affect the market dynamics of these instruments, as well as banks liquidity position. Following an earlier NBE directive that limited investment of insurance funds in real estate to 10 percent, the insurance companies were investing the bulk of their assets on time deposits at commercial banks. Through its latest directive, the NBE intends to channel these time deposits into T-bills. Although T-bills rates have improved following the introduction of competitive auctions, they remain around the minimum deposit rate and well below rates offered by commercial banks on time deposits.



The monetary policy stance of the NBE loosened with the onset of the COVID-19 pandemic. Annual average growth in reserve money dropped from 19 percent in FY18 to 14 percent in FY19 and about 9 percent in the first half of FY20. However, this relatively tighter monetary policy stance started to loosen since February 2020, as the NBE injected liquidity into commercial banks and expanded lending to the government as part of the response to the COVID-19 pandemic (Figure 9). As a result, average growth in reserve money increased to about 25 percent in the second half of FY20 and picked up further to 37 percent during the first half of FY21 (vis-à-vis the same period of the previous year). Meanwhile, growth in broad money supply, which had eased from 30 percent in FY18 to 22 percent in FY19 and 19 percent in FY20, increased to 22 percent during the first half of FY21. Over the past two years, broad money growth has been increasingly driven by credit to the private sector. Average annual growth in banks' lending to the private sector rose from 28 percent in FY19 to 36 percent in FY20 and remained strong at 35 percent in the first half of FY21.

Figure 9. Reserve money growth tightened in the first half of FY20 but accelerated since then
Monetary growth, year-on-year % change



Source: NBE.

Credit by commercial banks⁴ continued strengthening during July-December 2020. After slightly easing in FY20, credit accelerated to about 33 percent in the first half of FY21 (year-on-year). While the growth rates of credit directed towards domestic trade have slowed down since FY19, credit into housing and construction, and into imports, have accelerated substantially (Figure 10, left panel). Exports, imports, and housing and construction experienced the highest growth rates, while agriculture registered relatively low growth. Industry (with a declining share), exports, domestic trade, and housing and construction were the top four recipients of bank credit (Figure 10, right panel). During the first half of FY21, a 5 percent decrease in the collection of payments by commercial banks was recorded, which suggests some firms and households may be struggling to repay their loans due to the COVID-19 crisis.

The surge in private sector lending coupled with slowing deposits intensified liquidity constraints prior to COVID-19. Severe liquidity shortages in commercial banks were reported starting November 2019. This was caused by aggressive lending by private commercial banks, which accelerated in mid-2018 as authorities lifted the limit on private banks' outstanding lending that had been imposed to mitigate the inflationary impact of the October 2017 devaluation. This, this, coupled with the

4 This includes bank credit to public enterprises but excludes corporate bonds issued by the Commercial Bank of Ethiopia.

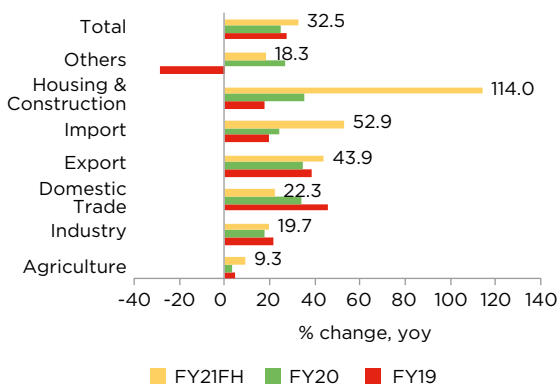


buildup in ten-year NBE bills that private banks were required to purchase as part of the 27 percent rule, brought loan-to-deposit ratios to over 100 percent for most banks.

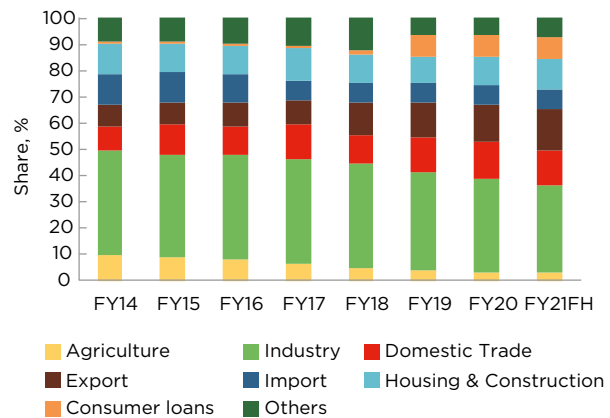
The repeal of the 27 percent rule coupled with liquidity injections from the NBE seem to have helped alleviating the situation in recent months. The repeal of the 27 percent rule in November 2019 has helped alleviate liquidity constraints. In addition, as part of the liquidity injections in response to the pandemic, the central bank has begun pre-paying part of the large buildup in ten-year NBE bills held by private banks. Toward the end of last year, it availed short-term loans amounting to 14.5 billion birr to commercial banks through two rounds of auctions to alleviate the liquidity shortage. Additional liquidity injections were provided in the early months of 2020 to help banks cope with the liquidity pressures caused by the COVID-19 pandemic. In May 2020, NBE issued directives that limit the amount of daily and monthly cash withdrawals from banks. As a result, the loan-to-deposit ratio started to come down since April 2020 from a peak of about 109 percent to about 103 percent in July (Figure 11). Liquidity ratios in commercial banks bottomed around December 2019 and have been recovering since then.

Figure 10. Credit into housing and construction accelerated in FY20, while it eased for trade and exports

Credit by commercial banks, % change



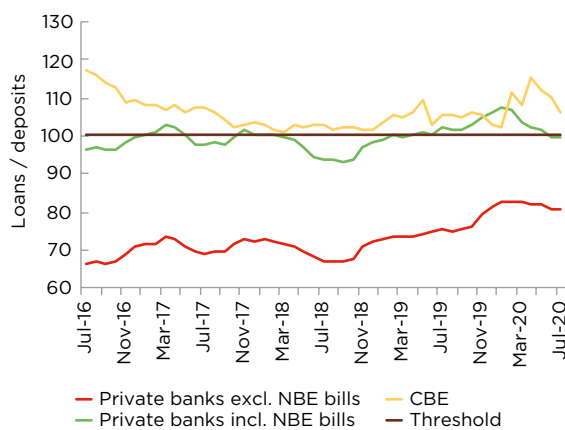
Sectoral composition of bank credit, % share



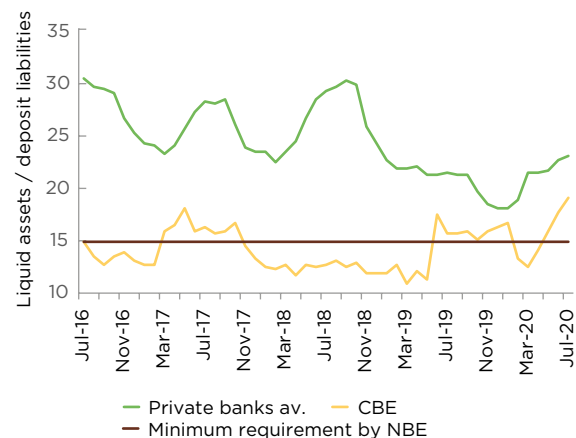
Source: NBE.

Figure 11. Liquidity constraints seem to have eased in recent months

Commercial banks: Loans-to-deposit ratio



Commercial banks: Liquidity ratio



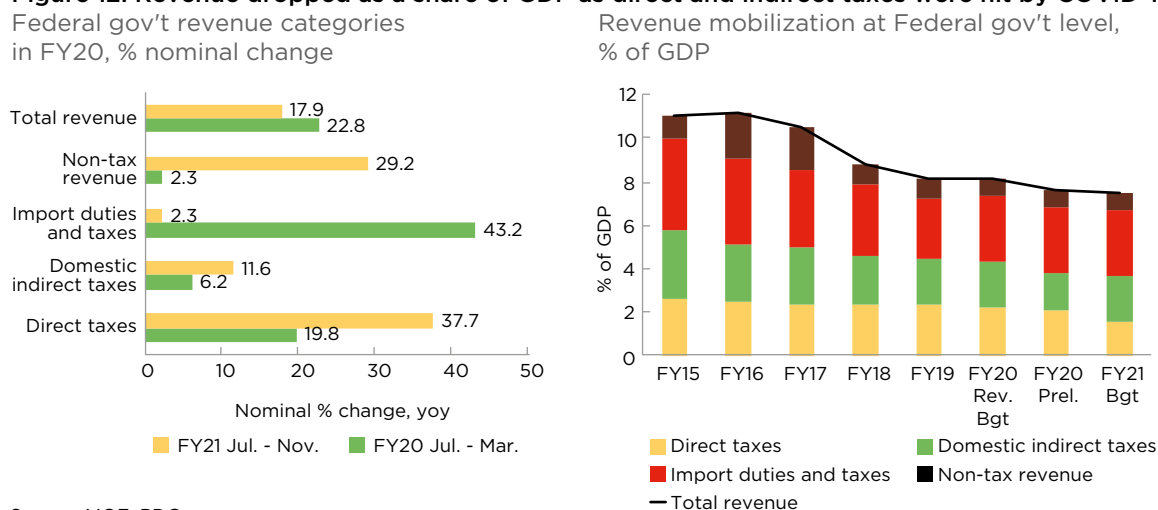
Source: NBE.



Fiscal developments

Revenue mobilization at the federal level is estimated to have weakened in the aftermath of COVID-19. While all revenue categories have continued expanding in nominal terms, the overall growth rate has eased in recent months if compared with that before the onset of the pandemic (Figure 12, left panel). As consumption plummeted, domestic indirect taxes (which were already performing poorly) declined by 0.4 percentage points of GDP in FY20 compared to FY19 (Figure 12, right panel). The improvement in foreign trade taxes was driven mainly by the removal of the depreciation allowance on imported vehicles (10 to 30 percent allowance on aggregated customs duty and taxes on vehicles) and revision of the second schedule tariff exemptions, which cut the exemptions from 2,000 tariff lines to 506. The Federal Budget for FY21 foresees revenue collection to remain largely the same as in FY20 in terms of percentage of GDP, with direct taxes expected to fall further while domestic indirect taxes pick up to their pre-COVID-19 levels; performance of foreign trade taxes is assumed to remain strong.

Figure 12. Revenue dropped as a share of GDP as direct and indirect taxes were hit by COVID-19



Source: MOF, PDC.

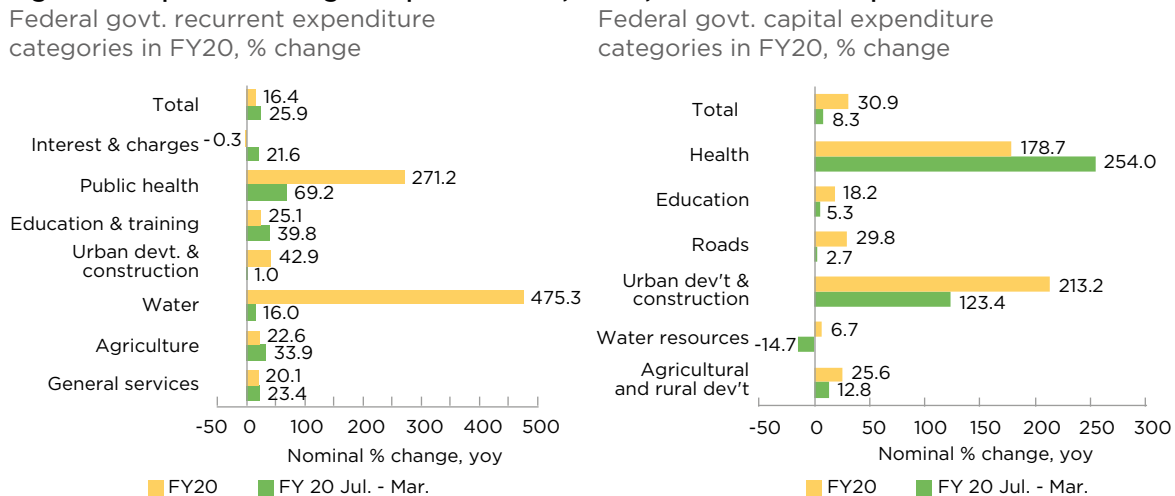
Despite the large increases in healthcare and other COVID-19 response spending, expenditure to GDP at the federal level dropped due to lower regional transfers. In the last quarter of FY20, following the COVID-19 outbreak, there were large increases in recurrent spending in health and water (aimed at the provision of improved supply and sanitation) (Figure 13, left panel). Capital spending on health and construction, which was already increasing significantly before the pandemic, continued its strong growth (Figure 13, right panel). Overall, capital expenditures by the federal government increased by 0.1 percent of GDP in FY20, while recurrent expenditures and regional transfers declined by 0.2 percent and 0.5 percent of GDP, respectively (Figure 14). There was apparently a greater need for capital than recurrent expenditures at the federal government level because of the COVID-19 pandemic. The Federal Budget for FY21 expects expenditure as a share of GDP to remain at the level observed in FY20.

The federal government fiscal deficit widened from 2.5 percent of GDP last year to 2.7 percent of GDP in FY20 (Figure 15, left panel). Despite the slight increase in FY20, the federal government deficit was below the revised budgeted amount of 3.3 percent of GDP (including two rounds of supplementary budgets in February and May 2020). External grants, which increased significantly to 1.2 percent of GDP in both FY19 and FY20, helped contain the fiscal deficit despite the poor revenue



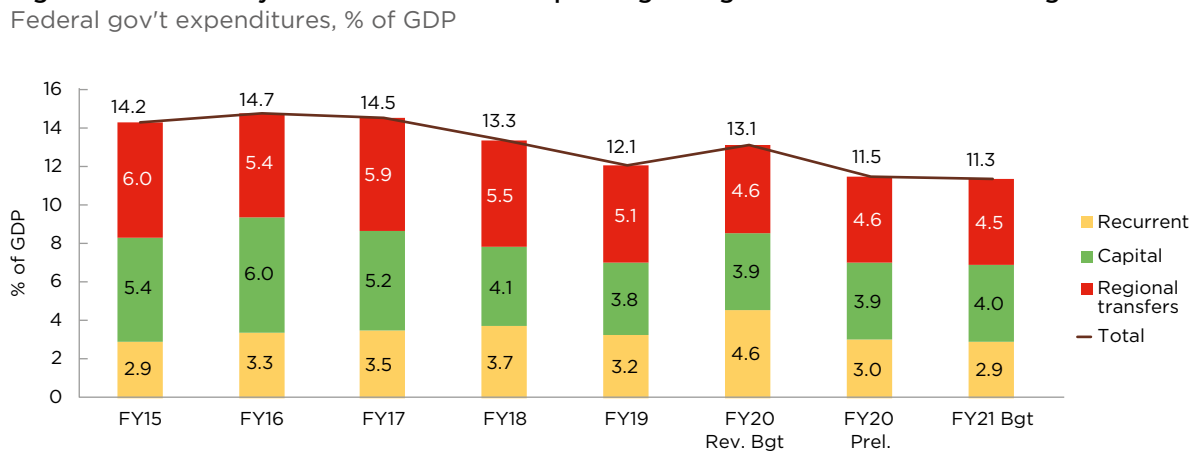
performance. Meanwhile, the overall public sector deficit (i.e. including SOEs)⁵ fell slightly from 7.6 percent of GDP last year to 7.4 percent as SOE borrowing continued to be restrained (Figure 15, right panel). While higher inflows of external loans following the pandemic have made an increased contribution to financing of the deficit, the government has also increased its domestic borrowing (including from the NBE), thereby contributing to expansion in the money supply. Accordingly, net domestic borrowing amounted to 1.7 percent of GDP in FY20 compared to 1.3 percent in FY19. The Federal Budget for FY21 expects the federal government deficit to remain at 2.7 percent of GDP. The NBE and non-bank institutions remain the most important domestic lenders to the Government. Despite initial plans to reduce NBE financing of the deficit, due to COVID-19, its contribution to financing remained at levels similar to those observed in previous years (1.1 percentage points of GDP).

Figure 13. Expenditure surged in public health, water, and urban development and construction



Source: MOF.

Figure 14. Preliminary data shows recurrent spending falling short from what was budgeted



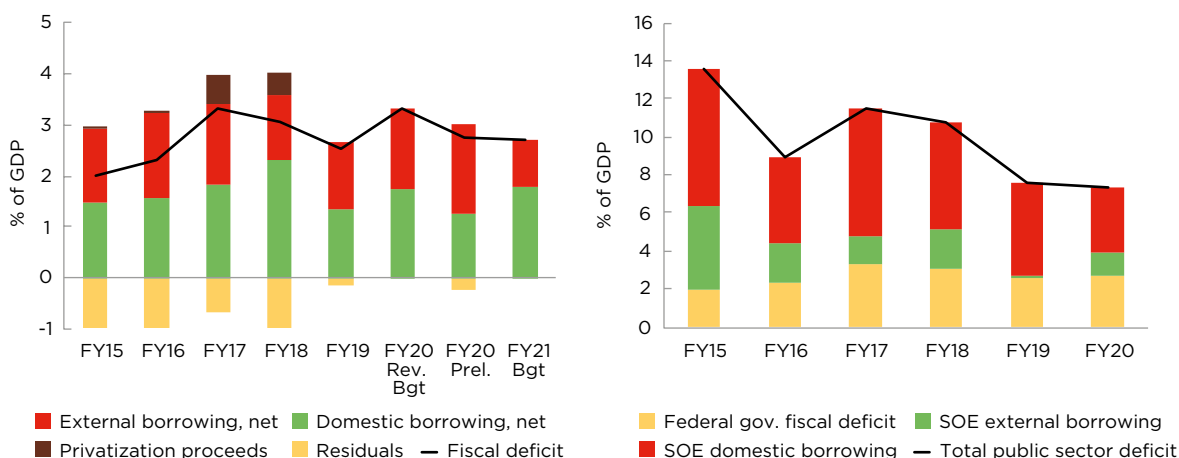
Source: MOF.

⁵ In the absence of comprehensive information on SOE revenues and expenditures, the overall public sector deficit is estimated by adding guaranteed domestic and external borrowings of SOEs (thus excluding borrowings by Ethiopian Airlines and Ethio Telecom) to the central government's fiscal deficit.



Figure 15. The deficit increased in FY20, but not as much as budgeted

Government deficit and financing, % of GDP Consolidated public sector deficit, % of GDP



Source: MOF.

Public debt developments

Despite a slight increase in external debt, public debt levels remained stable in FY20 as domestic debt declined following the restraint on public investment activities. Public and Publicly Guaranteed (PPG) debt reached about 56.5 percent of GDP as of June 2020, slightly declining with respect to June 2019 (Figure 16). External debt increased from 28.3 percent to 29.2 percent over the same period, while domestic debt decreased. The major factor for the increase in the level of external debt is presumably the increased financing from multilateral and bilateral creditors towards the end of the fiscal year to support the government’s response to the COVID-19 pandemic. Multilateral creditors account for about 44 percent of Ethiopia’s external debt, while the share of bilateral lenders is about a third of total. Private creditors (including US\$ 1 billion Eurobond issued in 2014) account for the remainder. Meanwhile, out of the domestic public debt stock, more than half is owed by SOEs. After a continuous increase over the past few years, external debt service payments as a ratio of exports showed a slight decline to 26 percent in FY20 (from 26.4 percent last year) as debt reprofiling agreement as part of the IMF Extended Credit Facility - Extended Fund Facility (ECF-EFF) arrangement and the Debt Service Suspension Initiative (DSSI) of G-20 countries helped to ease debt servicing pressures.

Despite the moderation in public debt levels, Ethiopia remained at high risk of debt distress. As per the Debt Sustainability Assessment (DSA) jointly conducted by the World Bank and the IMF in April 2020, the two export-related indicators—present value of debt to exports and debt service to exports ratios— continued to breach their respective thresholds, keeping Ethiopia at high risk of debt distress. The major factors contributing to the high risk of debt distress are the increase in debt servicing obligations due to the maturing of non-concessional loans taken a few years ago, coupled with the continued poor performance in merchandise exports. The authorities have taken steps to reduce vulnerability by controlling external borrowing, undertaking debt service reprofiling,⁶ and committing to move toward market-based exchange rates and foreign exchange market liberalization, both of which should improve foreign exchange availability and boost private sector activity and exports in the medium term. Authorities submitted in February 2021 an application to

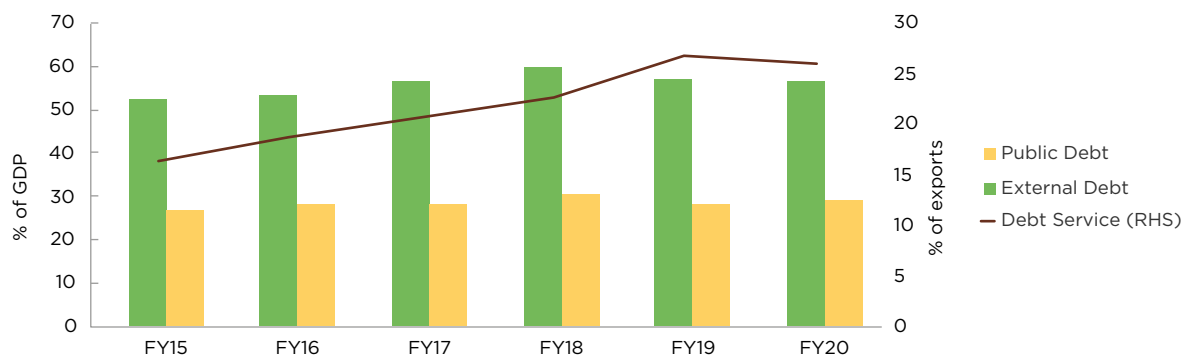
6 The authorities concluded in 2019 an agreement with creditors to restructure loans extended to the railway, sugar, and electricity sectors, amounting to about US\$4.5 billion (15 percent of total external debt).



receive debt treatment under the G-20 Common Framework, with the purpose of securing additional debt service reprofiling to meet the requirement to bring Ethiopia’s external debt risk rating to moderate by the end of the IMF’s ECF-EFF program. On February 9, Fitch Ratings downgraded Ethiopia’s Long-Term Foreign-Currency Issuer Default Rating to ‘CCC’ from ‘B’, interpreting that Ethiopia’s application to the G-20 Common Framework raises the risk of default for private creditors, including Eurobond holders. Other rating agencies have not made changes to their scoring.

Figure 16. Public debt is not estimated to have increased in FY20

Public and publicly guaranteed debt, % of GDP



Source: MOF, PDC, NBE.

Macroeconomic Outlook and Risks

The pandemic has caused an unprecedented synchronous and global economic recession. Forecasts point to a 4.4 percent contraction in global GDP in 2020 despite large fiscal and monetary support packages most countries have put together (International Monetary Fund, 2020b). This global recession is the sharpest since the one caused by World War II, and unlike previous crises, it is a synchronous one, with most developed and emerging markets witnessing deep declines in economic activity during the second quarter of 2020. The recession is caused by both demand and supply shocks. Initially, most countries adopted severe restrictions to economic activity—such as lockdowns, closure of schools and non-essential business, and travel restrictions—to contain the spread of COVID-19 and alleviate the burden on health care systems. These mitigation measures have affected domestic consumption and investment, and they have limited labor supply and production in non-essential industries. The effects of the crisis on domestic demand are likely to be protracted, at least until vaccines are fully rolled-out, and international demand is also expected to remain depressed in the coming years.⁷

In Ethiopia, the adverse impact of the COVID-19 pandemic on economic activity is expected to continue in FY21 before a rebound in FY22 and beyond. While the State of Emergency was lifted in September, domestic demand is expected to remain depressed due to the impacts of the pandemic (see Box 2), with growth slowing further to 2 about percent in FY21 (Table 2). Recovery in exports and foreign direct investment is expected to remain muted in FY21, hindered by the impacts of the pandemic on external demand as well as domestic constraints, including foreign exchange shortages. A sharper drop in imports would contribute to the further narrowing of the

⁷ According to UNCTAD (2020), global FDI inflows are expected to decline by a further 10 percent in 2021. Air transport is recovering more slowly than envisaged, and global passenger traffic is not expected to return to pre-COVID-19 levels until 2024, a year later than previously projected.



Table 1. Growth is expected to slow down further in FY21 due to the COVID-19 crisis

Annual % changes unless indicated otherwise	FY16	FY17	FY18	FY19	FY20e	FY21f	FY22f	FY23f
Real GDP growth, at constant market prices	8.0	10.1	7.7	9.0	6.1	2.3	6.0	7.5
Private Consumption	1.9	5.6	5.3	5.1	5.0	2.5	4.0	6.5
Gross Fixed Capital Investment	18.1	6.9	6.8	12.4	6.3	-3.5	5.2	4.8
Exports, Goods and Services	-8.1	6.1	5.0	3.0	-0.9	7.0	12.0	5.7
Imports, Goods and Services	0.0	-7.5	0.2	0.6	-2.3	1.5	2.2	2.5
Real GDP growth, at constant factor prices	8.0	10.1	7.7	9.0	6.1	2.3	6.0	7.5
Agriculture	2.4	6.7	3.5	3.8	4.3	4.0	4.0	4.0
Industry	20.6	18.7	12.2	11.5	9.6	3.5	9.0	16.0
Services	6.9	8.6	8.7	12.0	5.2	0.0	5.5	4.1
Inflation (Consumer Price Index)	9.7	7.3	14.5	12.5	19.9	19.0	10.0	9.0
Current Account Balance (% of GDP)	-9.5	-8.3	-6.2	-5.1	-4.1	-3.3	-3.7	-3.7
Fiscal Balance (% of GDP)	-2.4	-3.3	-2.9	-2.5	2.8	3.2	2.2	1.9
Debt (% of GDP)	56.2	58.9	59.6	57.3	56.5	56.6	55.6	53.3
Primary Balance (% of GDP)	-1.9	-2.8	-2.4	-2.0	-2.3	-2.5	-1.5	-1.1

Source: MOF, PDC, NBE, CSA, and World Bank estimate.
Notes: e = estimate, f = forecast.

current account deficit. Due to continued expenditure needs related to the COVID-19 pandemic, the fiscal deficit is expected to increase above 3 percent of GDP in FY21, prior to falling below 2 percent in subsequent years as revenue collection recovers and spending needs decline once the pandemic recedes. Inflation is forecasted to remain elevated in FY21 then fall to single digits by FY22 as tighter monetary policy is implemented once the pandemic abates. As key macroeconomic and structural reforms are fully implemented by 2022, foreign direct investment, exports, and economic growth are expected to strengthen in the medium term.

Downside risks to this outlook are high due to COVID-19 related uncertainty. If there was a resurgence in COVID-19 cases and a need to reinstate restrictive contention measures, production and consumption would be hindered further. Under that scenario, domestic economic activity and demand would be depressed much more dramatically, likely bringing Ethiopia into recession in FY21 and increasing financing needs. The pandemic could exacerbate the liquidity pressures faced by private banks, as firms and customers may be unable to honor their loan repayments, and deposits are likely to slow down. Deterioration in the finances of SOEs would endanger the CBE, which holds almost two-thirds of the financial sector assets. In addition, recovery could be hampered by continued depressed demand in air transport, tourism, and hospitality, which may suffer lasting impacts. The expected rebound in remittances may be bogged down by slower recovery in the labor markets of the United States and other developed countries, aggravating foreign exchange shortages, which would also further hinder prospects for attracting FDI.

Internal conflict, coupled with uncertainty surrounding elections, add to the risks. It is early to assess the human and physical toll of the armed conflict in the Tigray region that started on November



4.⁸ In terms of economic impacts, oil seed exports, goods, and services produced in the region are expected to be affected. In addition, with thousands of displaced people, the humanitarian situation is reported to be dire, which may add to instability and expenditure needs. Should the confrontations in Tigray and the other regions perpetuate and spread, political and economic stability in Ethiopia and the region could be at risk. In addition, civil unrest together with potential internet shutdowns such as those occurring in June and July 2020, if reintroduced, would affect economic performance. Foreign investment decisions are likely to be put on standby while the conflict lasts, and at least until the national elections take place (expected by June 2021).

In addition, Ethiopia is currently experiencing the worst locust plague in 25 years. Damages to the main 2019 crop were limited, as initially infested areas were mainly pastoral and because harvests had largely been finalized. However, if the mitigation measures the Government is putting in place with the support of development partners (DPs) are not effective, harvests in FY21 may be decimated. Food security risks would be compounded by disruptions in agricultural value chains caused by COVID-19, although the distribution of seeds and fertilizers seems to have been uneventful so far.

The outlook for poverty reduction, while positive, also faces significant downside risks. The effects of the COVID-19 pandemic on livelihoods are expected to be severe. As shown by the high-frequency phone surveys, household incomes are affected through a reduction in aggregate demand that affects the poorest households, in particular. Currency depreciation and energy price increases are also expected to have some negative welfare effects across the distribution, especially in urban areas. Moreover, reduced fiscal space will put pressure on the provision of social services during and after the economic downturn, with potentially detrimental long-term effects on the poor. Further detail on the impact of COVID-19 on households and firms is presented in the next section.

8 Following the capture by Federal forces of the Tigray regional capital, Mekelle, at the end of November, the Federal government announced that the main phase of its military offensive against the Tigray Peoples Liberation Front (TPLF), which was the governing party of the Tigray regional state, was completed. However, there are reports that the fight still goes on in certain areas. The Federal government has stated the focus on capturing and bringing to justice the TPLF leadership. A provisional regional government has been put in place and has started to put back in place the local administrative structures in the region.

BOX 2

Simulating COVID-19 impacts on the Ethiopian economy using a CGE model

Drawing from the World Bank's Mitigation, Adaptation and New Technologies Applied General Equilibrium (MANAGE) framework (van der Mensbrugghe, 2017), a Computable General Equilibrium (CGE) single-country model for Ethiopia has been designed. MANAGE is a multi-sector, multi-factors model comprising 61 economic sectors, 94 products, 33 labor categories (skilled, semi-skilled, and unskilled for each of the nine regions and two city administrations), and 28 household categories (rural/urban/small town for each of the nine regions and two city administrations). The model draws from Ethiopia's 2015 Social Accounting Matrix, the balance of payments, fiscal, and macroeconomic data from FY16-FY20 (from Ethiopian authorities), plus a series of assumptions regarding forecasts for some of these variables (from IMF and World Bank staff). The dynamic and recursive qualities of this CGE model allow simulating both the direct and indirect impacts of shocks and policy changes, which poses advantages over partial-equilibrium approaches and other models, especially when simulating a complex crisis with supply and demand shocks such as that caused by the Covid-19 pandemic (see, for instance, Calderón et al., 2020).

Results from simulating the Covid-19 shock using this model suggest the size of the economy would shrink by up to 118 billion ETB in FY20, 274 billion ETB in FY21, and 418 billion ETB in FY22 compared to the size it could have reached with a growth potential of 9 percent a year. This translates into estimated growth rates of 0 percent in FY21, and 5.9 percent in FY22, suggesting a protracted recovery rather than a straight v-shaped crisis. By FY25, the economy would be back to growing near potential. Projections are based in the simulation of a shock starting in FY20, drawing from historical data up to FY19, and do not incorporate the official growth rate in FY20.

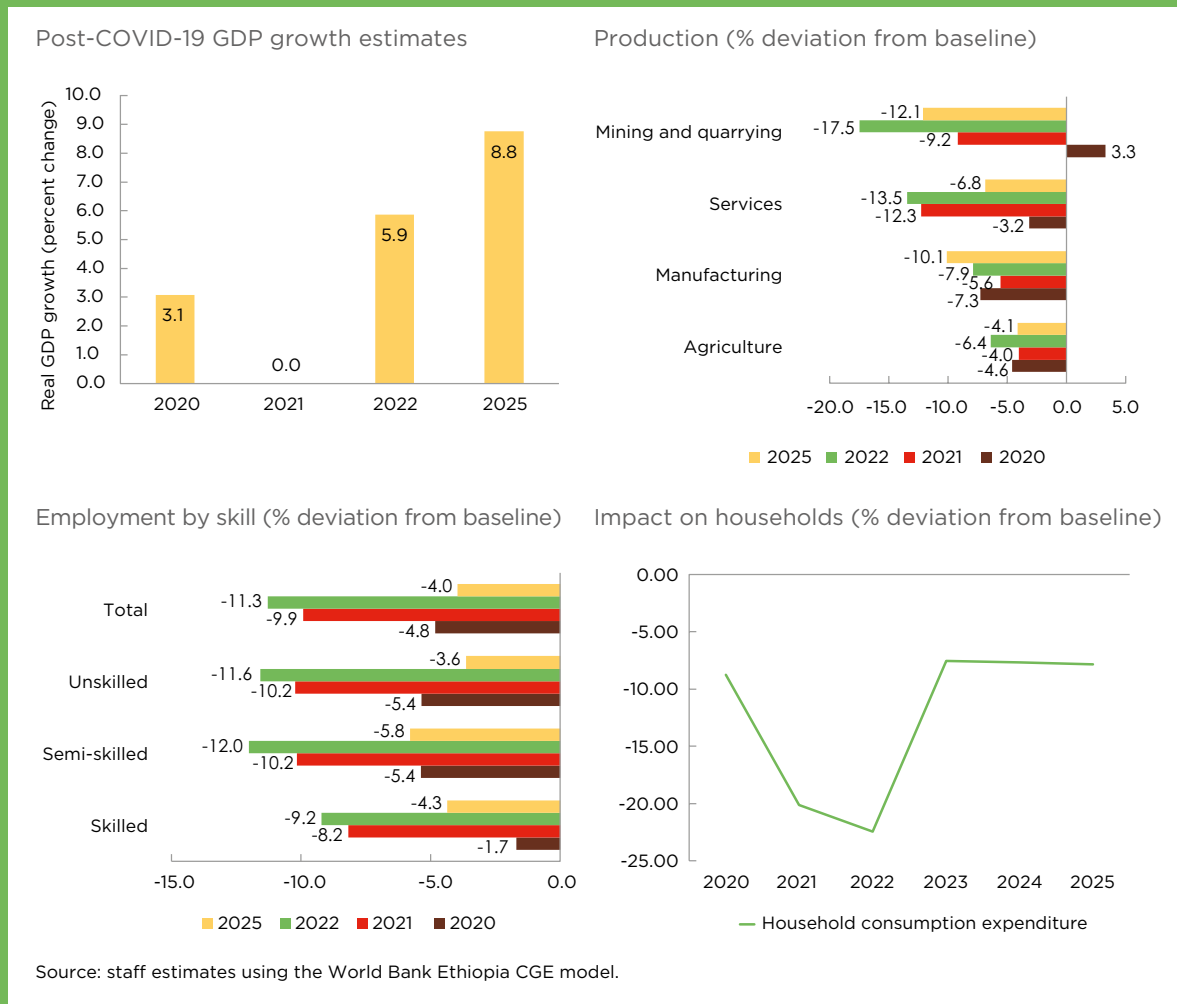
In terms of sectors, services are expected to be worse-hit, especially in FY21 and FY22 (above 12 percent decline in output compared to the pre-Covid-19 baseline), while it is expected to regain some ground in the medium-term. Meanwhile, the model suggests that manufacturing would be hit worse in FY20 (-7.3 percent), and, while it would see some recovery in FY21, a permanent reduction in output in the medium run could be expected (-10.1 percent by FY25). Agriculture is expected to be less severely affected, with drops in output expected to range 4-5 percent in the near term. Private investment could drop as much as 33 percent by FY21 (compared to the projected pre-Covid-19 level) due to lower FDI and lower domestic savings, and it will likely take several years to record a full recovery.

Employment could drop by up to 10 percent in FY21 relative to a non-COVID scenario with the economy growing at potential, and effects could be long-lasting. The semi-skilled (with secondary education) are expected to be worse hit. As a result of lower employment levels and depressed demand in general, household income could drop by nearly 40 percent in FY21, in nominal terms. The real drop in consumption would be around 20 percent in FY21, with people recurring to savings to procure their food and other basic needs. Both rural and urban households are expected to be affected alike. The adverse effects would be reversed progressively as the effects of the pandemic fade away.



BOX 2

Simulating Covid-19 impacts on the Ethiopian economy using a CGE model (continued)





2

COVID-19 impacts on households and firms in Ethiopia

This section discusses the COVID-19 impacts reported by respondents to two high-frequency phone surveys. The COVID-19 pandemic and its negative economic effects create an urgent need for timely data and evidence to help monitor and mitigate the social and economic impacts of the crisis and protect the welfare of the least well-off in Ethiopia's society. To monitor the impacts of the COVID-19 pandemic on Ethiopia's economy and people, the World Bank Ethiopia team, in collaboration with the government, designed and implemented two high-frequency phone surveys, one with formal firms in Addis Ababa (HFPS-F)⁹ and one with households (HFPS-HH).¹⁰

⁹ The phone monitoring survey of firms monitors the effects of and responses to the Covid-19 pandemic on firm operations, hiring and firing, and expectations of future operations and labor demand. To assess the impact on firms, the team took a stratified sample from an administrative register of all formal firms in Addis Ababa. Survey data collection began in mid-April 2020, and firms are called back every three weeks for a total of eight survey rounds. This data helps support decision making on possible policy responses and can be used to assess the effectiveness of government interventions as they are being implemented.

¹⁰ To monitor the impacts of the Covid-19 pandemic in Ethiopia on households' welfare, the team selected a subsample of households that had been interviewed for the Living Standards Measurement Study (LSMS) in 2019, covering urban and rural areas in all regions of Ethiopia. The 15-minute questionnaire covers a series of topics, such as knowledge of Covid-19 and mitigation measures, access to routine healthcare as public health systems are increasingly under stress, access to educational activities during school closures, employment dynamics, household income and livelihood, income loss and coping strategies, and external assistance. Survey data collection started at the end of April 2020, and households are called back every three to four weeks for a total of seven survey rounds to track the impact of the pandemic as it unfolds and inform government action. Details on the survey can be found at: <https://www.worldbank.org/en/country/ethiopia/brief/phone-survey-data-monitoring-covid-19-impact-on-firms-and-households-in-ethiopia>.



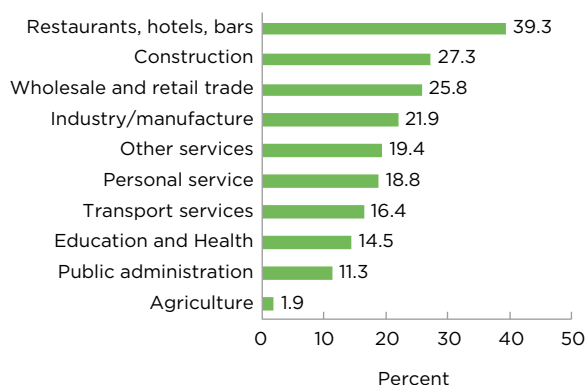
COVID-19 impact on employment

The COVID-19 pandemic has affected economic activity in Ethiopia with significant adverse effects on employment, particularly at the onset of the pandemic. Employment rates plunged in the early days of the pandemic, with 8 percent of respondents losing their job at the beginning of the outbreak, particularly those who were self-employed or working as casual laborers (HFPS-HH). The share of respondents who lost their job was highest in the hospitality sector, construction, and wholesale and retail trade (Figure 17, left panel), sectors that either require close human contact or are highly covariate with the business cycle. Job losses were higher in urban (20 percent) than in rural areas (3 percent) and higher for women (13 percent) than for men (7 percent). Employment rates rebounded in the second half of 2020 reaching pre-COVID levels in rural areas but remaining slightly lower than before the pandemic in urban areas (Figure 17, right panel). So far, it appears that COVID-19 has had a small yet persistent effect on jobs volume in Ethiopia.

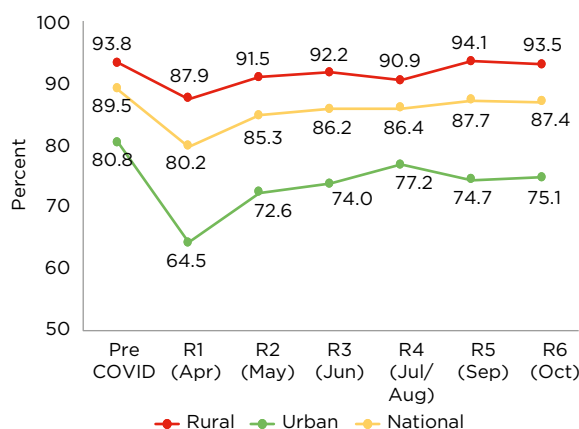
Female-headed households have lower employment rates than male-headed households—before and after the onset of the COVID-19 pandemic—with different reasons for losing one’s job. When looking at reasons for losing their jobs, most of male- and female-headed households in urban areas reported the COVID-19 pandemic as the main reason, specially at onset of the pandemic, but in May many female-headed households (20 percent) reported being ill or taking care of ill relatives as a main reason, compared to only 8 percent of male-headed households. In rural areas, most male-headed households reported in May temporary layoffs or seasonal work as reasons for being out of work, whereas female-headed households report being ill or losing their jobs due to the pandemic as main reasons. By October, the main reasons for being out of employment in rural areas were temporary layoffs and illness. In urban areas, we observed the same trend as in early months of the pandemic with female-headed households reporting being ill or taking care of ill relatives as the main reason for losing jobs while male-headed households reported seasonal work as the reason for losing jobs.

Figure 17. Employment losses have been more severe in services sectors and urban areas

Share of respondents who lost their job, R1, by sector



Share of respondents that are employed



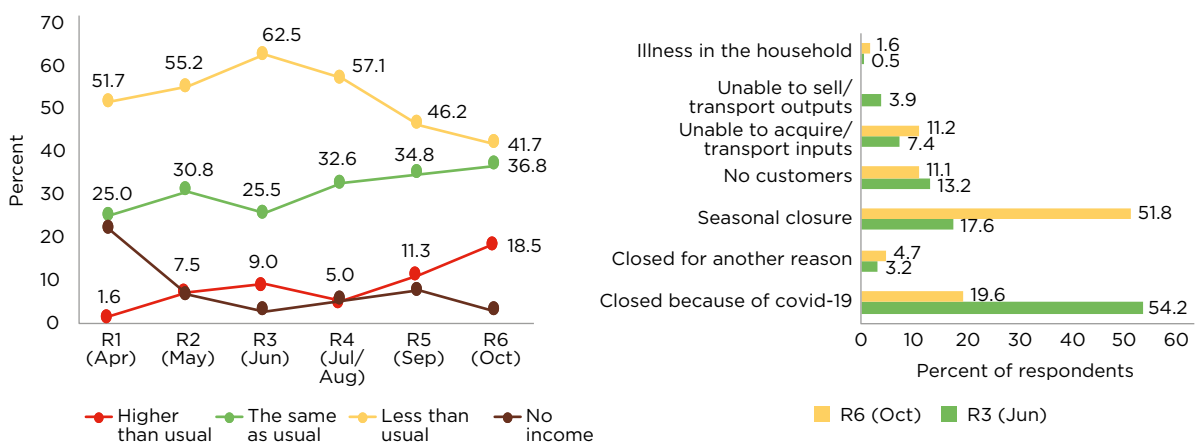
Source: HFPS-HH, 2020.

The COVID-19 pandemic has also had a significant impact on non-farm household enterprises. In the second round of the survey (R2),¹¹ which largely corresponds to May, about 20 percent of households ran a non-farm household enterprise. By the third round (R3), one month later, 67 percent of these enterprises were still operational; the other 33 percent had closed, some temporarily, some permanently. In most cases, closures were a consequence of the COVID-19 outbreak: “usual place of business closed because of coronavirus” (54 percent) and “no customers” (13 percent). Of those June households still operating a nonfarm family business, almost two-thirds indicated that income from the business was less than it had been in May (R2) (Figure 18, left panel). The reasons most often stated were: (i) there were no customers, (ii) the place of business is closed because of coronavirus, and (iii) they are unable to sell their products (Figure 18, right panel). By October (R6), 87 percent of households running a non-farm household enterprise were still operational. Closures were mainly due to seasonality (52 percent), including due to the Ethiopian New Year and Meskel holidays, with another 20 percent reporting the coronavirus as the main cause. Over time, fewer households in non-farming activities reported losses in their income, with only 40 percent of non-farm households reporting income losses in October.

Figure 18. Business income have decreased due to lack of customers and closures

Share of respondents with changes in nonfarm family business income

Reasons for lower business income for respondents with reduced incomes



Source: HFPS-HH, 2020.

Since the onset of the COVID-19 pandemic, workers layoffs in Addis Ababa have been largely limited. Although the share of formal firms in Addis Ababa firing workers has remained fairly low—presumably due to the State of Emergency Proclamation, which did not allow firms to lay off workers—it has consistently outnumbered the share of firms with new hires. Overall, 18 percent of firms in the sample (which are formal, registered firms in Addis Ababa) reported to have laid off workers since April 1, 2020, while only 5 percent had hired new workers. About one-third of manufacturing firms had reportedly fired workers, compared to 15 percent of services firms. Firms’ profit expectations have taken a large hit, with 69 percent of firms expecting profits to be “much lower” in the current year. Firms are mainly affected through a collapse in demand for their products and services. Given the challenging business environment induced by the pandemic, the removal of the State of Emergency Proclamation at the beginning of September may put workers at risk of being laid off.

¹¹ Round 1 (R1) was collected between April 22 and May 13, 2020. Round 2 (R2) was collected between May 14 and June 3, 2020. Round 3 (R3) was collected between June 4 and 26, 2020. Round 4 (R4) was collected between July 27 and August 14. Round 5 (R5) was collected between August 24 and September 14. Round 6 (R6) was collected between September 21 and October 14.



COVID-19 impact on income and livelihoods

The COVID-19 pandemic has had severe impacts on household incomes, resulting from reduced employment and wages. About 55 percent of respondents reported that household incomes were either reduced or had completely disappeared, affecting urban and rural households alike in the early weeks of the pandemic (R1). In October (R6), income losses continued for 26 percent of households. Total household income has fallen for a higher percentage of female-headed households compared to male-headed households. Although job loss was limited, incomes of urban households are primarily affected through reduced demand and thus income from self-employment, wage employment, and non-farm household enterprises as well as job losses. The firm survey shows that real wages declined by 14.1 percent for high-skilled workers in Addis Ababa and by 3.7 percent for low-skilled workers in April 2020, compared to the same period of the previous year. In rural areas, seasonality (which creates fluctuations in income) could also be at play, with the survey starting as the lean season—associated with lower incomes—began.

The majority of the respondents are concerned about the impact of the coronavirus on their health and livelihoods, though fears about the coronavirus seem to subside with time. In June, four months into the pandemic, 71 percent of respondents were very or somewhat worried that they or a family member will fall ill with COVID-19. In October 56 percent expressed the same type of worry. Similarly, in June, about 81 percent made it clear that the pandemic is a substantial or a moderate threat to their finances. By October a lower proportion of households (70 percent) felt the same.

Although households were hit hard by the pandemic, by October, only 3 percent had received outside assistance from the government, NGOs, or religious institutions. For those receiving assistance, the main types were free food (74 percent) and direct cash transfers (20 percent). The government contributed 51 percent of assistance in October. A slightly higher percentage of female-headed households received some form of assistance and received assistance was higher in monetary terms.

COVID-19 impact on educational attainment of children

Even before the pandemic, large differences could be seen in schooling outcomes between urban and rural children in Ethiopia and, to a lesser extent, between children in the bottom welfare quintile and those at the top. In 2016, more than 65 percent of youth ages 15-24 in urban Ethiopia had completed primary school (grade 8). In comparison, the corresponding figure for rural areas was only 21 percent. Children from low-income households in rural areas tend to drop out of primary school early, promoting the intergenerational transmission of poverty.

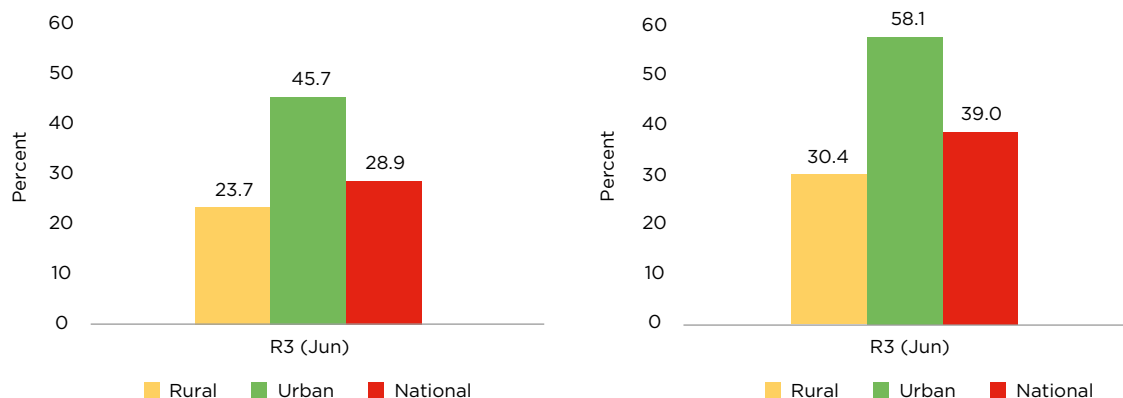
COVID-19 could exacerbate the existing inequalities in schooling outcomes. On March 16, 2020, Ethiopia closed all pre-primary, primary, and secondary schools, likely exacerbating existing inequalities in access to education. In addition to students losing valuable months of schooling, school closures deprive many poor children of food because they often rely on school feeding programs—for example, all children in Addis Ababa public schools participate in a twice-daily school feeding program. Temporary school closures may also lead to children from vulnerable households dropping out permanently, especially in rural areas, where early drop-out is rife even in ordinary circumstances. Girls are even more vulnerable as the risks of gender-based violence, underage pregnancy and marriage. The long-term impacts of lost months of schooling and the lack of good nutrition will be particularly severe for children in poor families because it jeopardizes their ability to build human capital and thus their earning potential.

Most primary and secondary students had no opportunity to learn during school closures. The COVID monitoring survey shows that nationwide, in households with children who had been in school before the outbreak, about 29 percent of primary school students and 39 percent of secondary school students were engaged in distance learning activities in June (Figure 19). This means that during school closures, 7 out of every 10 primary students and 6 out of every 10 secondary students had no opportunity to learn. Rural children still trail urban children in benefiting from distance learning—almost twice as many urban children who had previously attended primary or secondary school are now engaged in learning activities. An important action in the short term will be to ensure that disengagement during the temporary closures do not lead to permanent dropouts, in particular among girls and vulnerable rural households. In the longer term, devising policies or interventions that keep children from poor rural families in school longer will be crucial in any attempt to share the benefits of growth more widely.

Figure 19. Few children are engaged in learning activities during school closure

Share of children who previously attended school who are engaged in learning activities, primary school

Share of children who previously attended school who are engaged in learning activities, secondary school



Source: HFPS-HH, 2020.

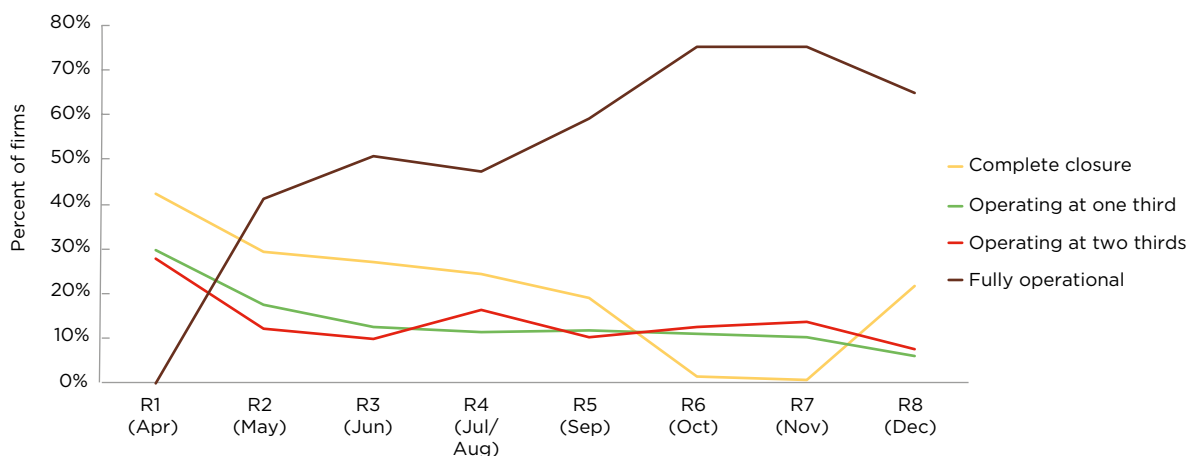
COVID-19 impact on firms

Results from the phone survey of firms show that COVID-19 and related containment measures have substantially affected firms' operations in Addis Ababa. At the onset of the pandemic, over 40 percent of businesses had closed due to COVID-19 related restrictions and impacts, and 32 percent of businesses reported no revenues in the last complete month (March or April). In August (Round 6 of the survey), almost no firms remained closed in the three weeks preceding the survey, and 75 percent of firms in Addis Ababa were again operational full-time, a significant increase compared to the previous rounds (Figure 20). There were some firm closures reported in October (R8), possibly due to Ethiopian New Year festivities rather than COVID-19-related reasons. Overall, 10 percent of firms in the sample have remained closed since April 1, 2020, when the survey started (and thus possibly have permanently closed). Own-account firms were most likely to have remained closed over this period. Firms are primarily affected by a significant fall in demand for products and services. Restricted movement of workers forced closure of businesses, and closure of marketplaces is another channel through which the pandemic and related containment measures have affected firms.



Figure 20. Firms are gradually resuming operations

Share of firms operational according to number of days over the last 21 days



Source: HFPS-F, 2020.

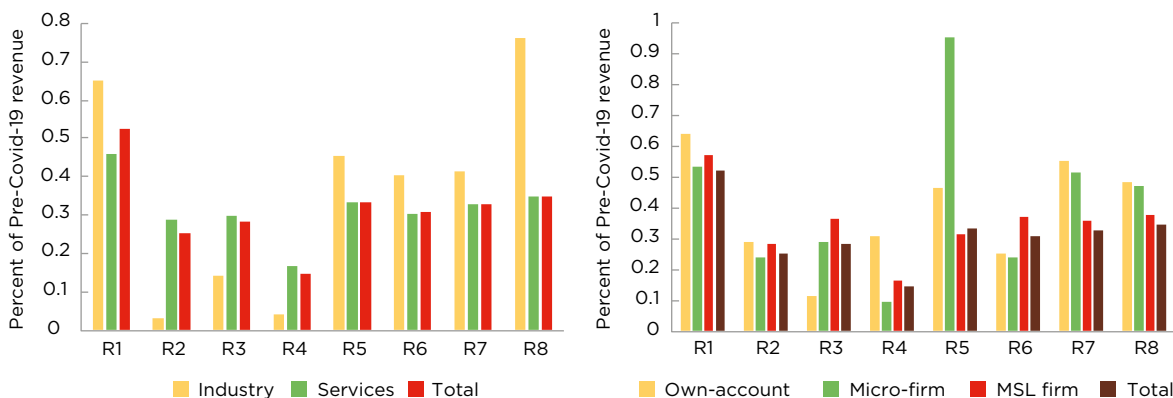
As a result of this contraction in demand, sales revenues of firms remain exceptionally low. About 38 percent of firms reported earning no revenues at all in the last complete month prior to the survey. Median monthly sales revenues for surveyed firms fell to 22 percent in May (R3) before starting to recover, reaching 26 percent in July (R5). Firms in industry were initially hit harder than those in services as many of them halted production, with median revenue dropping to just 15 percent in late April/early May (R2). More recent survey rounds suggest some rebound in firm sales revenue, while remaining significantly below pre-COVID-19 levels. The sector showing the strongest recovery has been industry, with firms reporting 75 percent of the pre-COVID-19 level of revenue in October (R8). By size, own-account firms seem to have been hit harder than micro-enterprises and small, medium, and large enterprises,¹² with their revenue bottoming at 12 percent in May (R3) (Figure 21). Expectations for recovery remain subdued, with only two percent of firms expecting to hire new workers in the three weeks after the time of interview. At the same time, however, few firms expect to lay off workers in the coming three weeks.

A survey conducted between May and August of more than two-thirds of the firms installed in Industrial Parks (IPs) confirmed most firms were operational at the time of the interviews, but the majority had experienced drops in production and demand. About 10 percent of surveyed firms reported closing temporarily due to COVID-19, and only one had closed permanently as a result of the pandemic. Of those that were closed temporarily, 27 percent reported closing for less than 4 weeks, and another 36 percent reported closing for between 4 to 8 weeks. About three out of four firms declared to have experienced a reduction in production, and a similar share reported a reduction in sales. The reported average decline in sales was 57 percent (Mengistu et al., 2020).

Firms in industrial parks that are domestic-market-oriented seem to be more affected by both supply and demand shocks. Of the export-oriented firms surveyed in IPs, 45 percent responded that they could have sold more if their production had not been limited, compared to just 30 percent among domestic-market-oriented firms, suggesting weakened internal demand. On the supply side, most firms declared that the main factor constraining production was access to foreign inputs,

¹² Most firms (44 percent) in this sample of formal firms in Addis Ababa are own-account firms (only the owner works in the firm, and there are no payroll employees), followed by micro-firms (1 to 5 payroll employees) (43 percent). Given the low prevalence of small (6 to 30 employees), medium (31 to 100 employees), and large (100 or more employees) firms, these three categories are lumped together for analytical reasons and account for 13 percent of the sample.

Figure 21. Firm sales revenues are recovering but remain much lower than prior to the pandemic
 Mean firm sales revenues during the last complete month, by sector
 Mean firm sales revenues during the last complete month, by size



Source: HFPS-HH, 2020.

as firms were affected by disruptions in value chains and trade routes. In addition, 75 percent of domestic-market-oriented firms reported affordability of foreign inputs as being an issue for them, compared to just 25 percent of export-oriented firms. This is compounded by the lack of foreign currency faced by non-exporters.

In response to some of these challenges, authorities adopted measures to support firms in IPs, particularly exporters. The Ministry of Revenue introduced a tax exemption for the import of materials and equipment aimed at containing COVID-19, which has facilitated the repurposing by some firms of production lines toward manufacturing personal protective equipment (PPE). In addition, authorities have temporarily allowed access to the domestic market for export-oriented firms affected by the drop in global demand. Lastly, train and freight transport prices have been reduced in support of exporting manufacturers. Thirty-one percent of the surveyed firms in IPs indicated having benefited from COVID-19 response measures. Despite the resilience exhibited early on, firms in IPs see largely negative prospects for the coming months. In the most likely, regular scenario, firms on average expect to lose 16.7 percent of workers and see their order volume decrease by 20.1 percent.

Economic recovery and expectations for poverty reduction

These effects on firm revenue and the subdued expectations will have significant impacts on economic recovery. With formal firms not hiring, a reduction in aggregate demand will also affect the self-employed. Casual laborers—comprising the poorest households in urban areas with poverty rates in excess of 30 percent—are hit particularly hard by an expected downturn of the economy. Self-employment is among the main livelihoods in urban Ethiopia, with 44 percent of urban households deriving their main income through self-employment. Moreover, the Government of Ethiopia is likely to face reduced fiscal space, which will put pressure on the provision of social services during and after the economic downturn. Government spending and investment have been an important engine of poverty reduction in the past, and reduced spending resulting from decreased government revenue and foreign exchange may have detrimental long-term effects on the poor.



Households in urban areas are affected most heavily by the economic consequences of the pandemic. Urban poverty declined from 26 percent in 2011 to 15 percent in 2016. As growth is expected to slow down due to COVID-19 impacts, the pace of poverty reduction would also decrease. Poverty reduction in urban Ethiopia has been tightly linked to increasing returns to self-employment, exactly the kind of employment that is most heavily affected by social distancing measures put in place to reduce the overall impact of the pandemic (e.g., small shops, coffee stands, roadside cafeterias, shoe shiners, casual laborers).

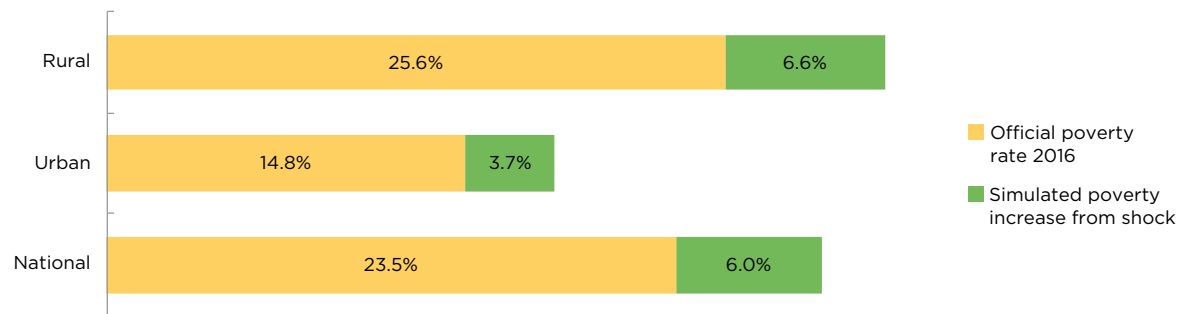
Although rural areas are less affected, the negative economic consequences of the virus are still being felt. Poverty reduction in rural Ethiopia has been driven mainly by agricultural growth, especially in places that are well-connected to urban markets. If demand for food in urban areas drops significantly (linked to subdued activity in accommodation and food services as well as decreasing urban incomes), farmers' incomes would also suffer. Although recovering from the stark reduction in incomes after the onset of the pandemic, around one-third of households who relied on farming for their livelihoods in June still reported a reduction in income over the past month. By October, a lower proportion of households (19 percent) reported income reductions. In addition, agricultural growth has been driven in part by increased use of modern inputs, such as improved seeds and chemical fertilizer. The COVID monitoring surveys show that some farmers have struggled to farm normally. In June, 7 percent of farmers had been unable to start the agricultural season normally, as 40 percent of them lacked seeds and 18 percent lacked fertilizers. In October, 5 percent of farmers were still facing difficulties, with 67 percent being affected by a drier than usual rainfall season. This, together with the ongoing locust outbreak, could affect crops and result in increased food insecurity.

While Ethiopia has made strong progress on poverty reduction, vulnerability has remained high and is likely exacerbated by the pandemic. Between 2012 and 2016, close to half of the population in rural areas and small towns experienced at least one spell of poverty (meaning that they were below the poverty line at some point during this period). The high level of vulnerability means that a considerable share of households is at risk of falling into poverty in a severe income shock. To illustrate, a shock across the country that reduces household consumption by 10 percent would, all else being equal, raise the poverty rate by 6 percentage points (from 23.5 to 29.5), eliminating all the progress made on poverty reduction between 2011 and 2016. In urban areas, a shock of this magnitude would raise poverty by over 3.5 percentage points, pushing an estimated 800,000 people below the poverty line (Figure 22). In rural areas, where a higher proportion of the population is clustered just above the poverty line, the rise in the poverty level would be 6.6 percentage points (or 5.7 million people).



Figure 22. A small reduction in consumption would increase poverty drastically

Simulated increase in poverty rates from a hypothetical 10 percent decrease in consumption



Source: World Bank staff estimates based on HCES 2015-16.



PART 2

Special focus: Ensuring a resilient recovery in Ethiopia





3

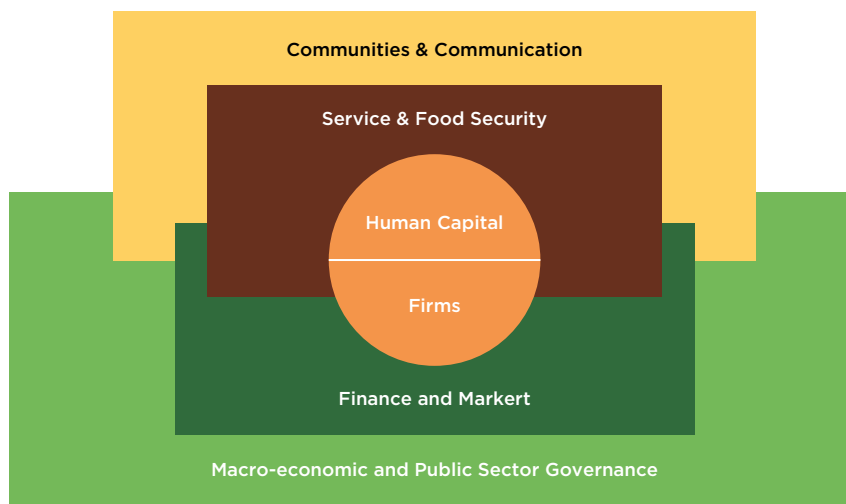
Policy options towards a resilient economic recovery in Ethiopia

Across the world, a myriad of economic response measures aimed at supporting relief and restructuring have been adopted in response to the COVID-19 pandemic. Among the most popular ones have been: deferrals in tax filing and the payment of social security contributions, as well as tax incentives for firms; provision of temporary unemployment benefits and/or wage subsidies conditioned to retain workers; measures allowing for the reprofiling of loans and credit; and monetary stimulus measures including the lowering of interest rates, large quantitative easing programs, and provision of credit and liquidity lines. Most developed countries have extended their job retention schemes as they face second and third waves of infections. Some of the loan forbearance and monetary measures have so far may have helped prevent many firms going out of business and, potentially, a financial crisis.

As the pandemic is lasting longer than initially expected, the immediate relief measures implemented at its onset may need to be rethought. There are questions about the effectiveness of some of the stimulus measures that are being implemented amid uncertainty. Fearing a protracted crisis, households and firms seem to be saving the bulk of the funding received from support schemes rather than increasing spending and investment. There are also claims that taxpayer money is going into artificially keeping alive firms that are no longer competitive and into maintaining jobs in sectors that may not see the same levels of demand in the future (e.g., tourism and restoration). Nevertheless, most countries have opted for providing additional fiscal and monetary stimulus, considering it is better to act and provide support rather than taking the risk of facing a domino effect in defaults. COVID-19 has also renewed the debate on the role macroeconomic policies should



Figure 23. COVID-19 policy response framework



Source: World Bank (2020b).

have in the coming decade, with economists in developing countries increasingly advocating for zero or negative interest rates in order to reignite inflation.¹³

Developing economies, which do not have the same policy space or the range of macroeconomic tools as developed economies and emerging markets, need from innovative country-specific solutions. For example, countries with limited fiscal space and a high degree of informality may not have unemployment insurance schemes in place and may lack the ability to target people through tax administration registries, or even through a national ID. In such environments, communities would play a role in identifying the poor and vulnerable, and cash transfers may be key to protect livelihoods.

This special issue summarizes the COVID-19 economic response policies adopted by Ethiopia so far and discusses additional measures that could support economic recovery going forward. As a departure point, it uses the approach of the World Bank (2020b) paper on Integrated Policy Responses to COVID-19. As shown in Figure 23, at the core of the response is protecting the poor and vulnerable and preserving human capital investments by ensuring continued food and services provision, as well as buffering firms, including by safeguarding access to finance and markets. Response measures need to be articulated through community outreach and an effective communication campaign and must be consistent with overall macroeconomic stability even if they are expansionary in the short run.

Containing the pandemic and protecting health

Background and measures adopted so far

In Ethiopia, the GoE swiftly implemented public measures to contain the pandemic and treat cases. Since March, authorities have implemented surveillance at borders and conducted contact tracing; established designated quarantine facilities in each region and new temporary isolation rooms in

¹³ "The covid-19 pandemic is forcing a rethink in macroeconomics." The Economist. July 25, 2020.

selected hospitals; disseminated health education materials across the country and conducted a door-to-door communication effort in Addis Ababa; and ensured the supply of drugs and protective equipment for case management and infection prevention, as well as laboratory equipment, reagents, and consumable supplies. To help contain the spread of the virus, the declaration of State of Emergency on April 8 introduced measures such as a nationwide ban on gatherings of more than four people, making the wearing of masks compulsory outdoors, and regulating the operation of transportation services, hotels, and restaurants under reduced capacity. Some of these measures remain in place even as the State of Emergency has been lifted.

The multisectoral response is articulated in the COVID-19 NERP and implemented through coordination mechanisms. The Plan takes a multisectoral approach to pandemic preparedness and response (agriculture, education, shelter and non-food items, food, health, nutrition, protection, site management, water and sanitation, refugees, and cross-cutting coordination and management), under three planning scenarios of increasing intensity of impact (low, moderate, severe). Sector-specific response plans have been developed in each of these areas. In November 2020, the Ministry of Health and the Ethiopian Public Health Institute jointly launched an updated COVID-19 response plan, revisiting the measures adopted so far and proposing some adjustments. A COVID-19 Ministerial Committee is meeting frequently to coordinate efforts, and subcommittees have been created to prepare and implement response measures in areas such as public health, security, and economics. In terms of communication, the Ministry of Health is providing daily public notifications when new COVID-19 cases have been identified, while the Office of the Prime Minister is announcing the range of mitigation and response measures being adopted.

Ethiopia has already initiated the procurement and delivery of COVID-19 vaccines. The development and implementation of a COVID-19 vaccine is envisioned as a key intervention to significantly reduce the threat of the virus. With the assumption that vaccines will be available in the countries during the first quarter of 2021, it is important to start preparing the infrastructure and key components of the vaccine implementation plan, prioritizing areas in which progress can be made. In this regard, Ethiopia is participating in the COVAX initiative, which will facilitate the procurement of vaccines to developing economies. Ethiopia has also conducted a vaccine readiness assessment and has prepared estimates of the cost of vaccine deployment with the support of development partners. Implementing agencies and priority target population groups have been identified, and points of delivery have been mapped. The facilities and logistics arrangements needed to preserve the cold-chain and store the vaccines seem adequate, and there is availability of trained human resources to provide safe injection at the different points of delivery / facilities. A prioritization plan has already been proposed, with health workers, those with co-morbidities and those older than 65 expected to receive the vaccine first.

What else could be done?

Ethiopia would need to address the identified regulatory, quality control and communication gaps towards the delivery of the COVID-19 vaccine. The readiness assessment identified, among others, the need to (i) put in place the necessary regulation for the procurement of COVID-19 vaccines and related supplies (and facilitating importation through the customs); (ii) develop standard operating procedures for the deployment; (iii) establish mechanisms for certification of facilities, performance monitoring, and integrity checks (including vaccine safety surveillance, complaint handling mechanisms, etc.); and (iv) initiate community engagement and advocacy efforts.

With the pandemic still unfolding, there is a need to continue reinforcing capacity to detect and response to Covid-19 outbreak. Enhancing alert investigation, point-of-entry health screening,



quarantine and isolation centers, and strengthening testing and monitoring remains key to ensure containment of the pandemic. Second, ensuring the provision of adequate labor force, supplies, and protective equipment remains critical both to the health sector and other essential industries. Third, there is a need to reinforce the risk communication and community engagement initiatives at all levels to avoid negligence when observing the needed protection measures, and to shield vulnerable population groups.

To ensure a resilient recovery, it will be crucial to continue strengthening healthcare systems, including those relating to infectious disease detection and response systems. First, there is a need to strengthen the outbreak preparedness and response system to address not only Covid-19 but also other disease outbreaks. This will require from improved data management (including digitalization of the data collection as well as enhanced analysis, reporting and data use for decision making), enhanced disease intelligence systems (for event-based surveillance, community surveillance, health facility surveillance, school surveillance, etc.), improved quality and networking of laboratories, and institutionalization of the detection and response system. Second, it will be important to strengthen the existing multi sectoral response coordination mechanisms at the federal and subnational levels as well as at the sectoral level. Finally, Ethiopia will need to continue working towards strengthening essential health services and frontline primary care.

Protecting livelihoods and human capital

In addition to COVID-19 infections and health concerns, loss of income coupled with disruptions in the provision of education and other essential services are affecting households. As discussed in Part I of this report, the negative impact is especially pronounced in households that are poor, dependent on sectors that are severely affected, such as restoration, or that are reliant on a single income earner. Women and adolescent girls are disproportionately at risk, and COVID-19 may exacerbate existing vulnerabilities for ethnic minorities, migrants, and refugees. A multisectoral policy response is needed to shield people—especially vulnerable groups, and governments are expected to protect households in the short term by supporting income, food security, and access to essential services, engaging communities and communicate to build trust and support coordinated action, and strengthening resilience in service delivery (World Bank, 2020b).

Food security

Background and measures adopted so far

In order to shield and stabilize agricultural markets and avoid shortage of food supplies, the government effectively introduced several response measures, including facilitating and protecting imports of staple food. Under the State of Emergency, markets have remained open. In April 2020, multinational companies were invited to import 18.1 million quintals of wheat, 104.3 million liters of edible oil, 3.2 million quintals of sugar and 1.7 million quintals of rice, products that are usually procured exclusively by State Owned Enterprises. The value of cereal imports increased by 40 percent in FY20.

Findings from the high-frequency survey of households show that these government measures have been successful in ensuring that households are able to buy staple food. By October 2020, 78 percent of households were able to buy wheat and 77 percent were able to buy edible oil. Of those who could not buy the respective item, they could not do so due to affordability (resulting from reduced incomes), rather than reduced accessibility (Wieser et al., 2020). In August, the government temporarily lifted import duties and taxes on five imported food items (edible oil, sugar, wheat, rice, and packed children's foods) to facilitate the supply, but inflation has remained high. Authorities



have announced that going forward they will prioritize the local production of wheat and edible oil to reduce reliance on imports and preserve scanty foreign currency. A cooking oil factory that is expected to be able to supply to more than half of the domestic demand was inaugurated in February 2021.

Authorities have also ensured the procurement and distribution of key agricultural inputs and the distribution of food rations to the vulnerable. The Ministry of Agriculture adopted a mitigation plan to ensure the distribution of agricultural inputs in the face of COVID-19, including protective measures for extension workers and, as of early September 2020, about 1.45 million metric tons of fertilizers had already been distributed (around 75 percent of the year's planned target). Second, authorities availed loans to Cooperative Unions to deal with supply shortage. Third, authorities have supported the provision of food rations to vulnerable groups, also in compliance of COVID-19 specific food distribution guidelines. According to preliminary estimates, 17.3 billion birr (about 0.3 percent of GDP) were spent in FY20 in emergency food aid. In addition, private sector and development partners have stepped up as well to provide food to those affected by the pandemic.

COVID-19 has increased risks of food insecurity, although the data collected so far suggests measures adopted to facilitate food provision and existing social protection schemes may have prevented a severe deterioration in the situation. Results from the high-frequency phone survey show that the percentage of households facing severe food insecurity declined from 10 percent in May to 7 percent in October 2020. Moreover, results from the high-frequency survey show that food insecurity in urban areas decreased between March and October 2020. The results of a recent study of a representative set of households in Addis Ababa are also encouraging, showing that food consumption in August 2020—five months into the pandemic—was similar to that of the same month of the previous year (Hirvonen et al., 2020). In rural areas, in turn, at the onset of the pandemic the household food insecurity increased by 11.7 percentage points and the size of the food gap by about half a month, while effects were reportedly muted for households that are beneficiaries from the Productive Safety Net Program (PSNP) (Abay et al., 2020). While measures seem to have so far minimized supply chain disruptions and availability of food, affordability challenges remain significant against a backdrop of persistent food inflation and rapid currency depreciation.

What else could be done?

As the COVID-19 crisis continues to unfold, authorities shall continue focusing on strengthening measures to prevent food supply disruptions and preventing price spikes. First, authorities would need to continue facilitating the provision of quality inputs (seeds, fertilizers, equipment and machinery, etc.), together with agronomic advisory services and climate information services. Second, authorities would need to continue supporting farmers' linkages to markets and further private sector integration to improve functionality of supply chains and help ensure adequate provision of food products during COVID-19 pandemic. Measures taken to address the liquidity challenges faced by many players in the supply chains would need to be strengthened as well, including through facilitating access to soft loans.

Going forward, to guarantee food security in Ethiopia, the production of a more diverse basket of food products, together with other resilience-enhancing measures, could be fostered. Measures such as the one allowing private sector participation in the supply of key staples and imported food items should be rolled-out further, as they are expected to increase the number of supply channels, improving resilience, while also contributing to enhanced competition and, eventually, a lowering of prices. Similarly, facilitating private wholesaler participation in the provision of agricultural inputs shall be also prioritized. Finally, it will be crucial to further strengthen efforts in the fight against the ongoing desert locust invasion through involving governments and different stakeholders.



Social assistance

Background and measures adopted so far

Safety nets are one of the few tools at the disposal of authorities to shield households in a country with widespread informality and lack of unemployment insurance, but their coverage is limited.

National urban and rural safety nets have proven to be effective social protection mechanisms in Ethiopia. Over 60 percent of beneficiaries of both safety nets are in the bottom two welfare quintiles. Under the Urban Productive Safety Net Program (UPSNP), around 60 percent of beneficiaries are women. Nonetheless, coverage is low. Only 11 out of more than 2,000 cities and small towns are covered by the UPSNP, and about 38 percent of rural districts are covered by the rural Productive Safety Net Program. Starting 2021, the Government has decided to further expand the UPSNP to a total of 83 cities to ensure that safety nets serve as a comprehensive line of defense against shocks. This broader coverage of urban safety nets will help guard against future shocks, serve as an investment in human capital, and help increase consumption.

The COVID-19 shock highlights the need to increase the adaptability and flexibility of both the rural and urban productive safety nets. In a situation where needs are high and resources are limited, governments like Ethiopia are challenged by competing financing demands and need to have the expertise and tools to make quick and often difficult decisions. The temporary waiving of work requirements under the public works component of the rural and urban safety nets adopted, coupled with activities to promote social distancing and advanced payments of three months to beneficiaries, are good examples of adaptation of safety net benefits and requirements in response to the crisis that authorities have adopted. Moreover, the next phase of urban and the rural PSNP includes a Contingent Emergency Response Component (CERC) component which can be activated quickly in case of a declared emergency and allows the Government to reallocate uncommitted funds rapidly from World Bank-financed projects toward urgent needs.

What else could be done?

Efforts to strengthen social safety nets will contribute to a more resilient economic recovery in the medium to long term. To respond to future shocks, existing safety net programs will need to incorporate a built-in mechanism that allows resources to be moved or shifted swiftly in response to urgent needs. In addition, authorities need to consider modernizing systems to enable improved targeting as well as faster and easier registration, payments and monitoring, including by adopting new technologies. Computer Assisted Personal Interviewing is expected to be rolled out for UPSNP household targeting in urban areas, and similar solutions could be adopted in other programs. Expanding e-payments and financial inclusion of the poor population targeted under the urban and rural safety nets is also a priority, although alternative channels should still be provided given the connectivity challenges and limited ownership of mobile devices by beneficiaries. Behaviorally informed communication through social protection schemes to communities heavily affected by the virus would be warranted to help them in the recovery process. Communities and NGOs could be partnered with to help reach out and support people in the recovery.

Active labor market programs are expected to play a key role as the economy recovers. Active labor market programs, labor-intensive public works, livelihoods support, and skills training can all be targeted to support household enterprises in the informal sector as well as severely impacted service sectors, contributing to economic recovery and job creation. Productive inclusion programs aimed at supporting self-employment, income diversification, and resilience have a critical role in ensuring that extremely poor and vulnerable groups (including women and refugees) have access to markets and services and are not socially excluded. Under the recently approved Urban Productive Safety Net and Jobs Project, the Government seeks to support less-educated urban

youth in entering the labor market through innovative skills development, on-the-job training, and mentoring. The Project also supports the Job Creation Commission (JCC) in reforming the public employment services by testing different models of Job Centers that strengthen the linkage between labor supply and demand, taking into consideration the particularities of each labor market (e.g., rural-urban differences, regional economic features). These Job Centers would expand and harmonize the existing Public Employment Services (PES) provided by different institutions.

Education

Background and measures adopted so far

In response to the crisis, the Ministry of Education developed a COVID-19 Education Sector Emergency Response Plan to respond to some of the abovementioned challenges. The objective of the Plan is to help contain the spread of the virus while minimizing the disruptions in education caused by the COVID-19 pandemic by engaging children at home and cultivating their life skills through peer teaching. The key areas identified to help students navigate through the crisis are: (i) mobilizing human resources to prevent the spread of COVID-19 by raising awareness on hygiene and sanitation management, (ii) providing education services through radio broadcasts for primary education and through digital technology for secondary and tertiary education, (iii) launching a school feeding program for the most vulnerable children, and (iv) establishing a special support program for girls and vulnerable groups through community messaging and other support systems. Partners, including the World Bank,¹⁴ are providing support to the government emergency response plan.

Various efforts have been made to improve access to distance learning and educational resources.

Following school closures, already ongoing radio broadcasts—initially designed as complementary to the lessons delivered by teachers—were adopted as the main channel for home learning. In practice, it is estimated that by August just 5 percent of primary school children had benefited from radio lessons and 14 percent of secondary school had received distance learning (including TV and mobile app). With the support of partners, authorities have expanded their coverage to areas that were not reached initially, which has resulted in improved access rates—particularly in rural areas—since the onset of the pandemic. Meanwhile, the Ministry of Science and Higher Education (MoSHE) has started to develop a Learning Management System to offer online learning for technical and vocational education and training (TVET) and higher education students. MoSHE has also launched an electronic library for higher education so that students can access electronic resources. It is also pursuing a plan for graduate students (Masters and PhD programs) to continue their studies online.

What else could be done?

Strengthening distance learning should remain a priority even after school closures. Despite the progress made in expanding distance learning, access to mass media varies across regions, so numerous groups remain excluded. Authorities need to keep working to further expand coverage and delivery platforms for distance learning, both to provide students with opportunities to continue learning while schools are closed and to modernize knowledge delivery and sharing going forward. Facilitating internet penetration and adoption as well as uninterrupted and reliable connectivity will be essential toward this end.

¹⁴ Following the declaration of Covid-19 as a global pandemic, the World Bank activated the CERC of the General Education Quality Improvement Program for Equity (GEQIP-E). The World Bank is also the grant agent for the Covid-19 emergency response fund of the Global Partnership for Education (GPE).



As schools have reopened in phases since October, it will be crucial to continue reinforcing hygiene, communication on disease prevention, and psychosocial well-being measures. Going forward, authorities will need to allocate the needed resources to improve hygiene and cleanliness practices at schools, and provide psychosocial well-being services, as well as services aimed at preventing sexual abuse and gender-based violence.

Supporting jobs and firms

Providing support to jobs and firms is particularly difficult in developing countries given the lower levels of capacity, constrained resources, and high degree of informality. While advanced economies have resorted to expanding unemployment protection and introducing temporary worker retention schemes, developing economies do not always have the fiscal space or tools to implement such policies. Measures supporting jobs and firms need to be tailored to a country's fiscal space, government capacity, labor markets, tax and social protection systems, and levels of informality. It is also important to try to understand the heterogeneity of shocks to different firms, sectors, and locations, as well as the urgency with which different potential recipients need assistance in each country context. To reduce economic scarring, identifying firms that are highly exposed to supply and demand shocks and implementing policy responses should be a priority where feasible. To avoid perverse incentives and longer-run market distortions, measures should be time-bound and transparent (World Bank, 2020b).

Background and measures adopted so far

Direct support to firms in Ethiopia has been instrumented mainly through tax deferrals and measures to back exporters. On March 27, the Government announced the first set of economic measures in response to COVID-19, including tax exemptions and preferential access to currency for those firms importing raw materials and equipment to be used in the prevention and containment of COVID-19. Further measures introduced in late April included the possibility of businesses carrying forward the loss incurred during the fiscal year, as well as some tax deferrals and waivers (Box 3).

Overall, adopted measures are likely to have benefited formal firms almost exclusively,¹⁵ although few firms seem to be able to access this support. Tax deferrals are expected to have helped formal firms delaying some of the payments and coping with temporary liquidity issues during the weeks in which most of them reportedly closed doors (April), although it may not have been sufficient to cushion the impacts for firms suffering from a protracted decline in business activity. Meanwhile, the measures forgiving tax debt, interest, and penalty payments owed to the tax administration could create some disincentives for firms that are up-to-date in terms of compliance and should be phased out. Complementary measures such as the temporary lifting of minimum prices and import duties as well as reductions in logistics fees are expected to have helped exporters and importers. According to the high-frequency phone survey of firms, only 2.6 percent of firms in Addis Ababa reported in April to have received government support, with the share declining to 0.5 percent by August.

¹⁵ Compared to 1.6 million business registered nationally (and there could be far more informal unregistered businesses), the number of federal-level taxpayers is just 37,070. While the number of taxpayers at the subnational level is expected to be much larger, the majority of firms are still unlikely to benefit from tax-related alleviation measures.

BOX 3

Economic response measures adopted by the Government of Ethiopia

Measures aimed at facilitating COVID-19 response

- Tax exemption for the import of equipment used in the prevention and containment of COVID-19
- Foreign currency provision by banks for importers importing goods and input materials used in the prevention of COVID-19

Financial sector measures to support firms and individuals

- Liquidity provision to the CBE and private banks to enable them to provide debt reprofiling and additional loans
- Increase in CBE's limit on the amount individuals can transfer through mobile banking, to limit in-person cash handling
- Opening of a special window for quick disbursements at the DBE to provide loans to address the financial constraints of micro- and small enterprises
- Provision of credit to microfinance institutions and cooperatives to support small-scale business and farmers and consumers cooperatives, respectively

Tax relief measures

- Expedited VAT returns by the Ministry of Revenue to support companies with cash flows
- Remission of tax debt (including principal tax, interest, and penalties) until fiscal year 2023 for more than 3,000 taxpayers
- Remission of interest and penalty for taxpayers who received a tax assessment notification for the period 2016-2019—the taxpayers must pay 25 percent of the principal tax owed within 30 days and pay 75 percent of the principal within one year from the date on which the installment agreement has been signed
- Waiver of 30 percent rental tax for education institutions and micro- and small enterprises by regional governments and city administrations, including a waiver of rental income tax for taxpayers who own residential properties and have waived rent payments for their tenants, whose monthly rent does not exceed 10,000 birr
- Waiver of four-month employment tax for workers who are required to stay home while still earning a salary, which allows the government to share about 50 percent of employers' wage cost of workers who are staying home for two months
- Extension of payment period for VAT and Turnover Tax so the filing time of returns and payments for the months of March, April, and May are extended until June 2020, without penalty and interest
- Tax deduction for COVID-related charitable donations, with deduction raised from 10 percent to 20 percent of taxable income for FY20 to thank donors and encourage more support
- Carryforward of loss incurred in FY20 to the next fiscal year, even if the business has already carried forward two losses
- Deferral to July 2020 of the pension contribution of private organizations for April-June



BOX 3

Economic response measures adopted by the Government of Ethiopia (continued)

Labor market measures

- Prohibition on discontinuing the contracts of private sector workers covered under the Labor Proclamation (1156/2011)

Temporary lifting of price controls and restrictions

- Support for manufacturers who export their products—based on the assessment to be conducted by the Ethiopian Investment Commission, manufacturers who cannot export their products to the international market will be allowed to supply their products to the local market for the coming two months
- Removal of the minimum price set by the NBE in the horticulture sector for flower exports
- Continued strengthening of measures by the Ministry of Trade and Industry to control price increments and supply shortages of consumer goods
- Temporary lifting of import duties and taxes on the import of five food items (i.e. edible oil, sugar, wheat, rice, and packed children's foods)

Logistics measures

- Granting of Free Terminal Handling Charges for 60 days for Ethiopian export cargo to the world that is gated in Djibouti Ports, starting from April 16
- Discounts on dry port and transport services for five months, effective May 1, 2020
- Provision of dedicated transport services for freights, with a 50 percent discounted price from Hawassa to Mojo, as well as a 73 percent discount for manufacturing sector exports using @ ESLSE_ for their exports
- Free-of-charge transport by Ethio-Djibouti Railway for export materials from industrial parks and export manufacturing industries that come through Mojo dry port to Djibouti for the subsequent three months, with a possible extension of offer until five months as of May 1, 2020
- Waiver of entrance gate payment for manufacturing export freights through Mojo port to Djibouti and a 50 percent discount for all other charges from their initial prices
- Provision of transport services for export freights at a 50 percent discount for export manufacturing industries that do not use railway services due to location distances

MSME support scheme (introduced December 2020)

- Wage subsidies covering 60 percent of workers' wages for micro-firms and 50 percent of workers' wages for small and medium firms to be provided for three months, covering a maximum of 7,000 birr (US\$ -178) of monthly salary
- Access to soft loans to cover three months of operational costs (utilities, costs of premises, and rent) at an interest rate of 5 percent, in partnership with the DBE
- Direct grants to informal businesses, at 10,800 birr (US\$ -275) for each informal business



What else could be done?

One of the recovery plan actions under consideration is to provide wage subsidies and partly cover the operating costs of firms in IPs, although that may not be enough to prevent job losses.

Now that the State of Emergency is no longer in place and firms are allowed again to fire workers, the introduction of temporary wage subsidies could be warranted to support firms and workers and prevent impacts on firm productivity in the long run through the loss of experienced workers. With their high degree of formalization, Ethiopia's IPs represent a context in which this kind of measure would be relatively easy to implement. Support could be operationalized through local banks making direct wage payments to garment sector workers in participating factories, which accrue as loans to factories and are underwritten by the central bank.¹⁶ However, wage subsidies may not be sufficient per se to prevent job losses, especially for firms with large recurrent costs (Box 4). Also, Industrial Parks have reopened and world exports seem to be recovering.

Support could be instead directed to struggling local firms. Granting access to credit could be the alternative to a large fiscal package.

As discussed in section 2.4, Part I, about a third of firms in IPs have already received some government support (Mengistu et al., 2020), whereas outside industrial parks just about 0.5 percent of firms had received some support (Bundervoet et al., 2020). Thus, aid could be geared towards local firms, although supporting firms outside IPs, in particular SMEs, is likely to be more challenging due to the high levels of informality, and the cost of the support package would have a significant impact on the deficit.¹⁷ In a welcome step, the Jobs Creation Commission, with the support of development partners, introduced in December 2020 a scheme targeting 24 thousand MSMEs, and providing wage subsidies, direct grants, and access to soft loans. However, that program remains limited in scope, as it would only support a small fraction of the 1.6 million businesses registered nationally. An alternative would be saving in measures with a fiscal cost, such as wage subsidies and tax waivers, and focusing in facilitating credit to the domestic private sector more broadly. Credit would help firms pay for their recurrent expenses and their workers as they restructure and readjust.

Efforts should focus on supporting productive SMEs, which would benefit from access to working capital, adoption of digital technologies, and adaptation to a new normal featuring social distancing rules.

Authorities could leverage existing and recently announced SME support programs and facilitate access to finance to viable SMEs, in particular those who had been honoring debt repayments, have a good record of credit worthiness, and have been operating successfully until the pandemic. Lending should focus on working capital and could be made conditional on worker retention. In addition, authorities could support the adoption of digital services among SMEs by designing—together with providers—specific internet access, web design and online shops, as well as mobile banking packages.

¹⁶ Woodruff (2020) provides a concise summary of the case for support to export-oriented industries and describes the government response in Bangladesh, which set up a US\$600 million concessional loan program.

¹⁷ In a May 2020 proposal titled *Business Sustainability and Jobs Protection Support to Cope with the Impacts of Covid-19*, the Jobs Commission estimated that providing three months of wage subsidies and short-term loans to all firms in IPs would cost about US\$41 million. Providing similar support to large firms would amount to US\$283 million, and to 75 percent of the MSMEs about US\$258 million.

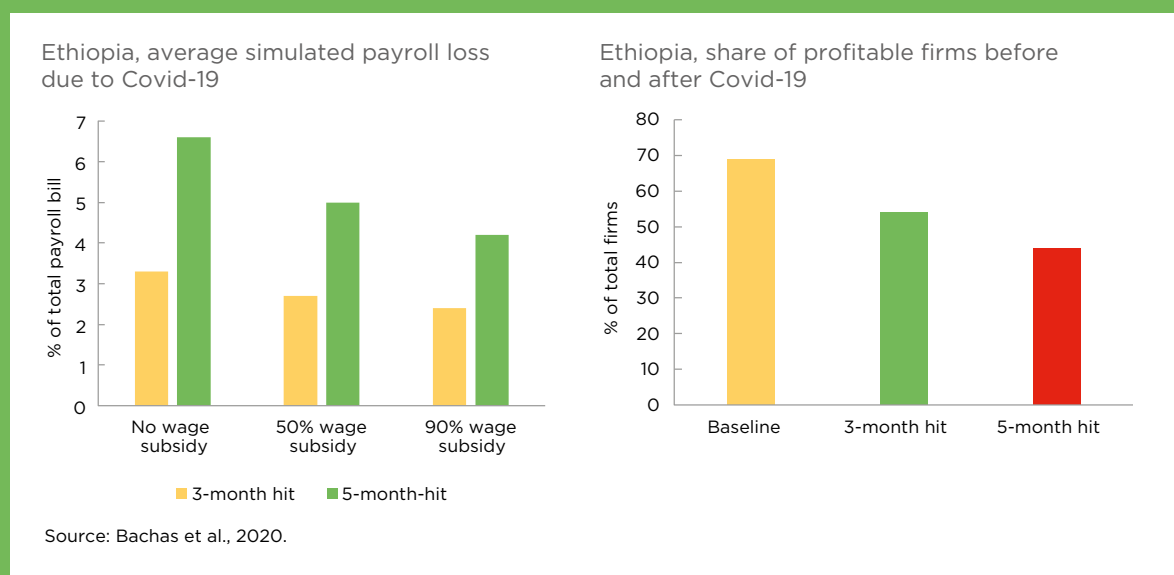


BOX 4

Simulation of the impacts of COVID-19 at the firm level

Bachas et al. (2020) simulate scenarios in which a demand shock¹ induces a drop in firms' sales over either three or five months and use corporate income tax data to estimate the impacts on firm profitability and revenue collection. Results for Ethiopia suggest the share of firms that is profitable (about 66 percent under the baseline) drops to 50 percent when simulating a hit that lasts three months, after allowing firms to adjust variable material costs. Firms that are not profitable after the shock would cut down their payroll bill by an average of 3.3 percent to try stay afloat. In sectors that are severely hit such as tourism the average payroll cut would be of 9.2 percent.

Introducing a wage subsidy would mitigate employment cuts only partly: even with a 90 percent wage subsidy the loss in yearly payroll would be reduced just to 2.4 percent (from 3.3 percent). This is explained because firms may have large fixed costs to pay (e.g. rent) and a reduction in labor costs is not sufficient to counteract the revenue loss. In particular, in hardly hit sectors (e.g. retail, transportation, accommodation services) the effects of a wage subsidy in mitigating employment losses are likely to be muted, although wage subsidies can save payroll for the low, and especially the medium-impact sector. While, on average, 13 percent of formal firms in Ethiopia exit the market in a given year, it is estimated that under a three-month impact scenario that figure would increase to roughly 20 percent. Overall, providing soft guaranteed loans to firms may be a more effective policy tool to keep them afloat, although the required resource mobilization would be substantial: the credit that would need to be made available just for formal firms would be equivalent to at least 0.8 percent of GDP.



¹ Depending on the economic sector authors assign firms to one of three groups—high, medium and low impact—which are assumed to face a 100%, 50% and 20% drop in demand respectively during the lockdown or period of reduced activity.

Authorities also could help firms by simply expediting cashflows and reducing paperwork. To continue alleviating firm liquidity constraints, authorities could finance the deferral on rent payment for production facilities for firms that are under strain, expedite VAT reimbursements and payments, and clear any arrears to suppliers to the Government and SOEs. In countries such as Vietnam, the tax authorities have also reassessed the presumptive tax obligations for small businesses affected by COVID-19; the challenge in implementing such a measure in Ethiopia is that the taxation on small/micro (category C) is under the authority of regional states, and introducing and implementing the needed regulatory changes would take time. Some regions have allegedly provided 25 to 50 percent cuts for presumptive taxpayers on their annual tax obligations.

To support the recovery of economic activity in the medium term, Ethiopia could rethink its investment incentives. Authorities could rethink the tax incentives framework, shifting away from blunt profit-based incentives (i.e. tax holidays and income tax exemptions) toward cost-effective incentives such as investment tax credits to the acquisition of machinery (World Bank, 2019). Finally, it will be key to ensure the implementation on the ground of recently adopted regulatory reforms aimed at improving the business climate, including the new Investment Proclamation and Commercial Code. Easing entry and exit procedures will go a long way in facilitating new investment, competition, and innovation.

Putting in place monitoring and reporting mechanisms will be important to assess the effectiveness of the different policies and adapt them as needed going forward. The immediate response to the pandemic required measures that were simple by nature and could be deployed rapidly, even when that could result in inclusion errors. As the policy focus shifts from mitigation and relief to supporting recovery, it will be important to start gathering as much information as possible in order to sharpen the purpose and effectiveness of policies and make the best use of public resources going forward. In this regard, introducing monitoring and reporting mechanisms as well as safeguarding measures that ensure policy interventions reach the targeted beneficiaries for the intended purpose will be crucial. For example, it will be important to assess whether the liquidity injections aimed at promoting access to credit by firms have indeed reached the SMEs and other intended beneficiaries.

Ensuring access to finance and financial sector stability

The financial sector response must balance the provision of liquidity to support businesses and households in the short term with the need to sustain financial soundness of the system over time. Firms around the world experienced unprecedented drops in revenue as nationwide lockdowns were put in place to slow the spread of COVID-19. Estimates based on data for 40,000 firms in 26 advanced economies show that if 2020 revenues fell by 25 percent, then in the absence of any rollover, debt service and operating expenses will exceed cash buffers and revenues in more than half of the firms (Banerjee et al., 2020). Many previously well-performing firms would not be able to survive this economic shock. There is a strong argument for providing liquidity relief to firms to enable recovery and protect jobs. Most countries responded with a range of measures to ease liquidity in the financial sector by exercising a significant degree of forbearance and putting in place lines of credit, guarantees, and generally more relaxed monetary conditions.

Background and measures adopted so far

The NBE has adopted a series of measures to facilitate access to credit while ensuring banking sector liquidity. NBE suspended the restriction on banks' medium- and long-term loans and advances to exceed 40 percent and 20 percent of total loans and advances, respectively, and relaxed provisioning requirements for restructured loans in both banks and microfinance institutions.



It also instructed banks to reschedule loans and avoid foreclosures for firms in affected sectors. Authorities also injected liquidity in March to private commercial banks and the CBE. The NBE issued a new directive that bans persons and companies from keeping over 1.5 million birr (around US\$42,300) in cash out of banks, with the aim of strengthening transactions through the banking system. NBE has also passed a directive that allows local banks to borrow from foreign banks; while this could help alleviate the shortage of foreign exchange that commercial banks are facing, it could give rise to currency mismatches and other risks to the sector.

Despite the measures adopted, own account and small firms have struggled to get access to credit. According to firm surveys, less than one in ten own-account firms also applied for a formal loan to run the businesses, compared to 15 percent among large enterprises (Bundervoet et al., 2020). Furthermore, none of the own-account firms obtained the loan that they had applied for, and micro-enterprises secured about 1.2 percent of the loan they had requested. By contrast, small, medium or large enterprise were granted 8.4 percent of the total loan amount that they had applied for to run the business. This is despite the provision put in place by the Government of Ethiopia in late April to provide loan support for small and micro Enterprises.

What else could be done?

As a starting point, the authorities could consider continuing and extending some of the measures already implemented. The restriction on banks' medium- and long-term loans share of portfolio, temporarily waived in response to the pandemic, could be permanently suspended, as the lending institutions are best placed to determine the tenor and terms of lending while observing business credit risks and fair lending practices. Meanwhile, forbearance measures could be extended further, although it would be important to first collect evidence of their effectiveness and to weigh the trade-offs between immediate response and medium-term stability (considering moral hazards and other potential risks).

Implementation of financial sector measures will need to ensure effective pass-through by the banking system for the resources to reach the ultimate intended beneficiaries. During the 2008-10 global financial crisis, many countries implementing similar financial measures found that banks were reluctant to expand credit to struggling businesses despite ample liquidity and availability of risk mitigation instruments. The Development Bank of Ethiopia could be one of the channels to provide borrowing to women and SMEs that are struggling to meet their payments (Girum et al., 2020), but it needs from a comprehensive reform. As the GoE considers further interventions, the following considerations will be important in the design: (i) address credit risk mitigation for lenders, (ii) ensure robust risk-sharing mechanisms between lenders and the scheme, (iii) target firms that need liquidity support, (iv) alleviate firms' liquidity pressures, (v) secure financing to fund the scheme, and (vi) clarify prudential implications (Jeasakul, 2020). These considerations should be taken into account, for example, when redesigning liquidity and loan provision schemes in a way that ensures funding trickles down to consumers (both firms and individuals).

Going forward, it would be also important to strengthen the enabling environment for digital financial services. To succeed, digital financial services will need reliable backbone and last-mile internet service as well as a comprehensive regulatory framework that envisages competition and covers any account-to-account electronic transfers. It will also be necessary to strengthen the payment infrastructure of the country to allow interoperability of account-to-account transfers.



Coordinating the macroeconomic response

The crisis response requires mobilizing a substantial amount of resources, while keeping macroeconomic stability and sustainability in mind. In the near term, macroeconomic policy should focus on facilitating the health response and cushioning the impacts on people and firms. Once the spread of the pandemic is under control and the containment measures have been lifted the macroeconomic policy focus could shift towards providing stimulus. Even then, as developing economies often face tighter fiscal space and have shallow financial markets and unsophisticated monetary policy instruments at their disposal, the effectiveness of demand-supportive expansionary policy may be low. When designing economic policy responses to the COVID-19 pandemic, it is important to select the instruments that are most cost-effective and that are also easier to implement from a bureaucratic standpoint. Building in flexibility is advisable, especially for new, unproven interventions that may require adjustment. Crucial to success will be effective coordination between the Ministry of Finance and implementing agencies, as well as open, clear, and consistent communication on the purposes and potential beneficiaries of the measures adopted.

Background and measures adopted so far

On the revenue side, relief has been modest and aimed mainly at formal firms. As discussed above, the main measures in support of firms thus far have consisted of tax and social security deferrals (until July), some waivers on employment tax and rental tax, as well as the possibility of carrying forward losses from FY20. These are measures aligned with international practices to help alleviate the liquidity situation for taxpayers affected by temporary business closures and/or the fall in demand. While an estimate of the cost of these measures is not available, the fiscal impact on FY20 finances is expected to have been muted. Thus, rather than the cost of the tax measures adopted, the decline in revenue collection vis-à-vis the pre-COVID-19 forecasts can be attributed almost entirely to the impact of the crisis, as corporate revenues and consumption started to plummet in March.

On the expenditure side, Ethiopia has adopted a package that is substantial but affordable and is mainly directed at containing the pandemic, protecting lives, and preventing people from becoming food-insecure. Ethiopian authorities adopted two supplementary budgets over the course of FY20 to reflect the unanticipated fall in revenue and the additional expenditure needs to respond to COVID-19. On the expenditure side, the envisaged package amounted to around 1.5 percent of GDP (52.4 billion birr) in FY20, of which health-related spending amounted to 0.7 percent of GDP, emergency food aid 0.5 percent of GDP, and emergency shelter and other non-food support 0.3 percent of GDP. Overall, the size of the fiscal package would be roughly similar to that adopted by the Philippines and greater than those of Vietnam or Myanmar (World Bank, 2020c), but below the average package announced by emerging market developing economies and OECD countries (around 5 percent of GDP). However, budget execution reports suggest that, while there was a significant increase in healthcare-related expenditure in FY20, total spending did not expand as significantly as expected, possibly as the food-security situation did not deteriorate as much as initially feared.

The monetary policy stance was relaxed temporarily to provide an adequate response to the crisis and mitigate systemic risks. As mentioned above, NBE has intervened decisively to mitigate the immediate impacts of COVID-19, including by supporting liquidity injections into the banking sector and providing cash advances to the government to help mitigate the unanticipated financing gap. To this purpose, reserve money growth has been boosted significantly since March. Overall, while there may be some inflationary effects in the short run, those are expected to be mitigated by the



weakening in demand caused by the pandemic. The temporary expansion of monetary policy is regarded as adequate and necessary to ensure financial stability and support the fiscal response to COVID-19.

What else could be done?

Fiscal policy in Ethiopia could remain supportive of pandemic mitigation measures in FY21. On the revenue side, the pandemic may make the introduction of new tax policy reforms (such as the new VAT Proclamation) more politically complicated. Authorities could nonetheless try immediately to boost revenue collection by focusing on implementation of the new excise tax proclamation and by improving tax compliance. In the medium term, a systemic revision of tax incentives and exemptions is warranted. On the expenditure side, redirecting public expenditures toward the health response, essential services and household income support will be crucial. To create the fiscal space needed to support pandemic response and recovery measures, it may be the time to undertake a review of all planned capital investments (including those led by SOEs), reassess their financial viability, and consider delaying new projects that are not critical. It is also important that the comprehensive draft Public Investment Management proclamation is adopted and implemented without delay. In addition, authorities may need to revisit transfers to subnational governments and institutional systems to strengthen local capacity and ensure adequate service delivery.

Progressive monetary policy tightening would need to be complemented with other measures aimed at reducing inflation. As the pandemic unwinds, monetary policy tightening is expected to resume in 2021, with the objective of bringing inflation down to single digits. This entails a deceleration in the pace of money creation, the replacement of cash advances from the NBE to the central government with Treasury bills, and any momentary provision of liquidity to be issued through market instruments. In order to ensure a more resilient recovery, a revised emergency liquidity framework would need to be put in place together with the required instruments and facilities, and authorities would need to introduce a modern monetary framework.

Completing the reform of the exchange rate regime will be key to ensuring a sustainable economic recovery in the medium term. Continued overvaluation in recent years has incentivized imports while negatively affecting the competitiveness of exports, leading to foreign currency shortages and a surging parallel market premium. This not only poses macro-financial challenges but also is a major impediment to medium-term export-led productivity growth and poverty reduction. In addition to taming inflation and pursuing faster currency depreciation in nominal terms, it is important that Ethiopian authorities fully implement the foreign exchange roadmap recently adopted by the NBE and streamline all the existing and distortionary surrendering requirements and foreign exchange allocation mechanisms. Implementation of exchange rate reforms is necessary to improve both the business environment and Ethiopia's external competitiveness, contributing to the recovery of exports and foreign investment in the medium term.

Linking the response to a sustainable recovery

In the long run, the COVID-19 crisis is expected to accelerate some of the megatrends that were already observed during the 2010s. Ethiopia will need to adapt to the new normal and try to take advantage of the opportunities created by the crisis. The pandemic, which has overwhelmed healthcare systems and disrupted the provision of education, is likely to hinder human capital formation in the coming years, and to exacerbate the trend of slowdown in total factor productivity growth. Governments may use arguments around public health and national security concerns to resort back to protectionism. Meanwhile, firms may rethink value chains around resilience,



accelerating automation and reshoring. As the demand for eCommerce and for services that can be provided online increases (Abay et al., 2020), governments, businesses, and people will need to accelerate their digitalization. Finally, as years in long-sought-after gains in poverty reduction are undone and the abovementioned trends affect the distribution of wealth, civil unrest—such as that experienced in France and some Latin American countries even before the pandemic—may become common, with rising requests for a new social contract (IMF, 2020a). Lower investment, the erosion of human capital, and the dislocation of value chains are also expected to hinder potential growth and productivity in the long run (World Bank, 2020a). Ethiopian authorities have the opportunity to embed these considerations into the country’s development strategy in order to be better positioned in the future to confront and/or benefit from the abovementioned megatrends. This section discusses reform areas that are of relevance to Ethiopia under the current COVID-19 new normal.

What can be done?

The crisis has exposed the limitations of digital services in Ethiopia, and the need to move away from the current market structure in order to allow the digital economy to flourish. For many years, Ethio Telecom’s monopolistic control has limited the scope for innovation, restricted network expansion, and limited the scope of services on offer. Despite recent improvements, mobile cellular subscriptions remain well below the Sub-Saharan African average, fixed-broadband subscriptions are exceptionally low at 0.05 per 100 people, and 4G mobile broadband coverage is only 4 percent of the population (GSMA, 2019). Affordability and reliability issues make it challenging for people and firms to work remotely and/or adapt to the pandemic through identifying other sources of income. In sight of these challenges, the current crisis reinforces the case to proceed as soon as possible with the partial privatization of Ethio Telecom and the issuance of new telecom licenses, as this is expected to promote competition and efficiency in digital services. Also, to maximize revenue collection from these transactions in a time in which it is badly needed, it would be important that the new licenses include rights to build infrastructure and provide mobile money services. Ethiopia has the lowest use of mobile money among all African countries at just 0.32 percent of adults, with the lowest level of female participation at just 10 percent of the total.¹⁸ In addition to boost digital access, fully reaping the gains of the digital economy will require several medium term actions, including, among others, the full implementation of the new e-Transactions Proclamation, improving logistics to facilitate e-commerce, and moving away from face-to-face services towards e-government.

As multinationals consider reshaping value chains and diversifying their supplying countries, fast-tracking of accession to the WTO would increase appeal for international investors. Ethiopia levies high trade tariffs, increasing the cost of consumer products by adding to high logistics costs and creating an anti-export bias—17.4 percent on average tariff level compared to 9.5 percent for Vietnam. By reducing tariffs and removing red tape and discretion, WTO accession can spur export-led growth while lowering import prices, contributing to growth and poverty reduction. In the context of COVID-19, WTO accession can also facilitate access to medicines, reduce exposure to counterfeit drugs, and help raise healthcare standards. To that end, first, authorities would need to conduct a review of tariff and non-tariff policies that considers reform impacts on poverty and government revenue. They would also need to undertake detailed assessments on how WTO commitments affect competition and efficiency in access to services, on health services and the production of medicines, and on the opportunities and challenges to the agriculture and agribusiness sectors from the introduction of Sanitary and Phytosanitary Standards in line with international best practices. Second, authorities must define and implement a WTO accession roadmap detailing needed legislative changes and capacity building activities. Third, a monitoring mechanism for trade policy

¹⁸ World Bank FINDEX 2017.



and WTO accession that links trade policy changes to expected development outcomes should be established (Brenton and Nyawo, 2020).

Ethiopia can also achieve a greener recovery. Policymakers could take advantage of lower oil prices to remove some implicit subsidies on fuel and kerosene resulting from slow adjustment of administered prices and the lack of collection of taxes and excises on these items. While the implicit kerosene subsidy is found to be progressive, it is not pro-poor (Mesfin and Gao, 2020). Removal of these implicit subsidies at this juncture would cushion inflationary impacts, while boosting revenue (even if part is off-budget) and helping attain a greener path of recovery in the medium to long run.

Mapping the way forward

The human and economic costs of the COVID-19 crisis for Ethiopia are severe and require a comprehensive and multi-sectoral policy response. A successful policy package would comprise both relief and recovery actions in a range of policy areas. To continue minimizing contagion through enhanced testing and isolation is expected to generate large gains and help prevent lockdowns and other measures that are disruptive to the economy. Meanwhile, relief measures in support of households and firms that are suffering the impacts of the pandemic, as well as improved access to finance, are warranted. Immediate relief and restructuring measures need to be complemented with policies that are supportive of a resilient recovery. Table 2 below summarizes the menu of policy options discussed in previous subsections.

Key principles should be considered when making policy decisions (World Bank 2020b). First, it will be important to weigh the need to protect people from COVID-19 with ensuring access to income, food, and essential services (including prevention and treatment of other diseases). There will also be trade-offs when designing support packages for people and firms, especially in the context of a large informal economy. In the presence of trade-offs, protecting the most vulnerable groups from health and economic impacts (e.g., elderly, women, self-employed), including by providing preferential access to vaccines, would be the priority. To the extent possible, policy decisions should be evidence-based; data on the implementation and effectiveness of the mitigation measures adopted so far could be used to inform the next package of measures. Given the high level of uncertainty, mistakes are likely to occur, and it will be important to build feedback mechanisms and adapt as necessary the measures taken. Good governance, transparency, and clear communication about the proposed package of measures will be key to ensure the trust and cooperation of all social and economic agents and to ease any tensions. Success in containing the pandemic and mitigating the crisis requires a whole-of-society approach.

Several of the measures proposed are fiscally neutral, making the response package affordable. Among the policy options discussed in this report, updating safety net benefits to compensate for inflation is expected to have a cost equivalent to about US\$150 million, while support to firms could be ideally articulated through programs facilitating access to credit, thus minimizing the fiscal costs. Other relief measures listed in Table 2 are not expected to have a direct fiscal cost. Among the measures aimed at achieving a resilient recovery, most of them are technical and legal reforms that are expected to be fiscally neutral. The phasing out of tax holidays could render up to 0.6 percentage points of GDP in additional revenue collection, while VAT-related tax expenditure is estimated to amount to over 3 percent of GDP and could be reduced as well (World Bank, 2019). Crucially, strengthening healthcare systems and expanding safety nets to respond to this and future shocks is expected to be costly and will require boosting revenue collection; in the short to medium term, mobilizing resources from DPs can help make it affordable.



Table 2. Summary of policy options in response to COVID-19 and toward a resilient recovery in Ethiopia

Area	Relief and restructuring	Resilient recovery
Containing the pandemic and protecting health	<ul style="list-style-type: none"> Address identified gaps to procure and deploy a COVID-19 vaccine. Supply primary and secondary health facilities with the needed staffing, medicines, supplies, and protective equipment Reinforce risk communication and community engagement initiatives at all levels 	<ul style="list-style-type: none"> Strengthen the outbreak preparedness and response system by digitalizing data management and improving systems for disease surveillance Strengthen response coordination mechanisms at the federal and subnational levels as well as at the sectoral level
Protecting livelihoods and human capital	<ul style="list-style-type: none"> To ensure food security, continue facilitating the supply of quality inputs (e.g., seeds, fertilizers) and the functioning of markets while observing pandemic containment measures Update safety net benefits to address the continued loss in purchasing power Reinforce hygiene, communication on disease prevention, and psychosocial well-being measures 	<ul style="list-style-type: none"> Facilitate private wholesaler participation in the provision of agricultural inputs and key food staples (e.g., wheat) to increase resilience Expand safety net coverage and enable improved and faster registration by adopting new technologies Make the development of distance learning platforms a priority
Supporting jobs and firms	<ul style="list-style-type: none"> Focus on providing access to credit and working capital Leverage existing and recently announced SME support programs and support access to finance for viable SMEs 	<ul style="list-style-type: none"> Shift from tax holidays to incentives facilitating machinery acquisition and worker training Implement the new Investment Proclamation and Commercial Code, easing entry, exit, and competition
Ensuring access to finance	<ul style="list-style-type: none"> Suspend the restriction on banks' medium- and long-term loans share of portfolio Undertake an assessment of the effectiveness of forbearance measures Redesign liquidity and loan provision schemes in a way that ensures funding trickles down to customers (both firms and individuals) 	<ul style="list-style-type: none"> Strengthen the regulatory framework to facilitate digital financial services Strengthen the payment infrastructure of the country to allow interoperability of account-to-account transfers
Coordinating the economic policy	<ul style="list-style-type: none"> Continue cushioning the impact of the crisis and supporting relief spending through accommodative fiscal and monetary policies in FY21 Do any needed liquidity injections through market instruments such as auctions 	<ul style="list-style-type: none"> Adopt and implement the Public Investment Management Proclamation and use it to reassess projects in the pipeline, to ensure the sustainability of public investment Replace cash advances from the NBE to the central government with T-bills Strengthen liquidity management and adopt a modern monetary policy framework Introduce a market-determined exchange rate to absorb future shocks and regain competitiveness
Achieving a sustainable recovery		<ul style="list-style-type: none"> Implement the new Proclamation on e-Transactions Conduct assessments and prepare a roadmap toward WTO accession Phase out fuel subsidies to attain savings and promote green recovery



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