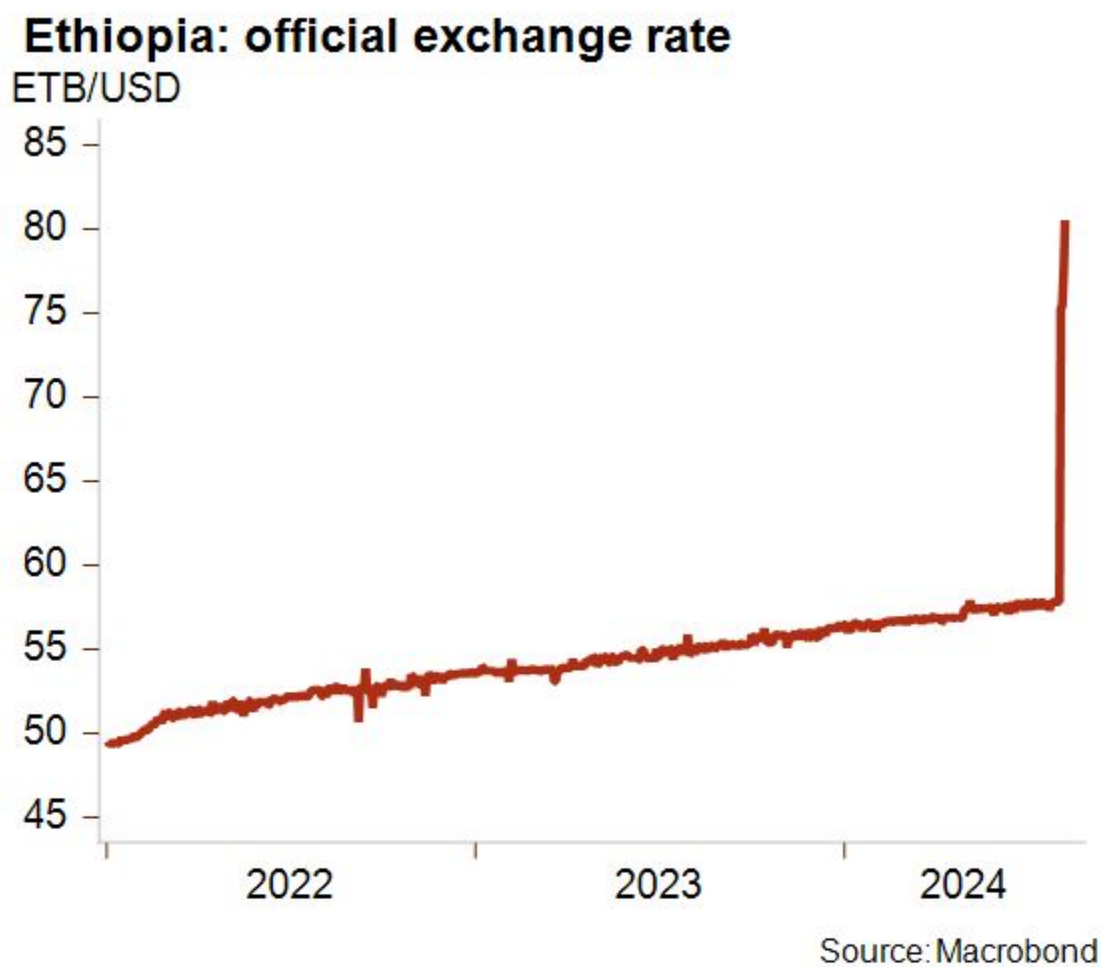
Ethiopia: The floating of the birr unlocks badly needed IMF support | Credendo

Event

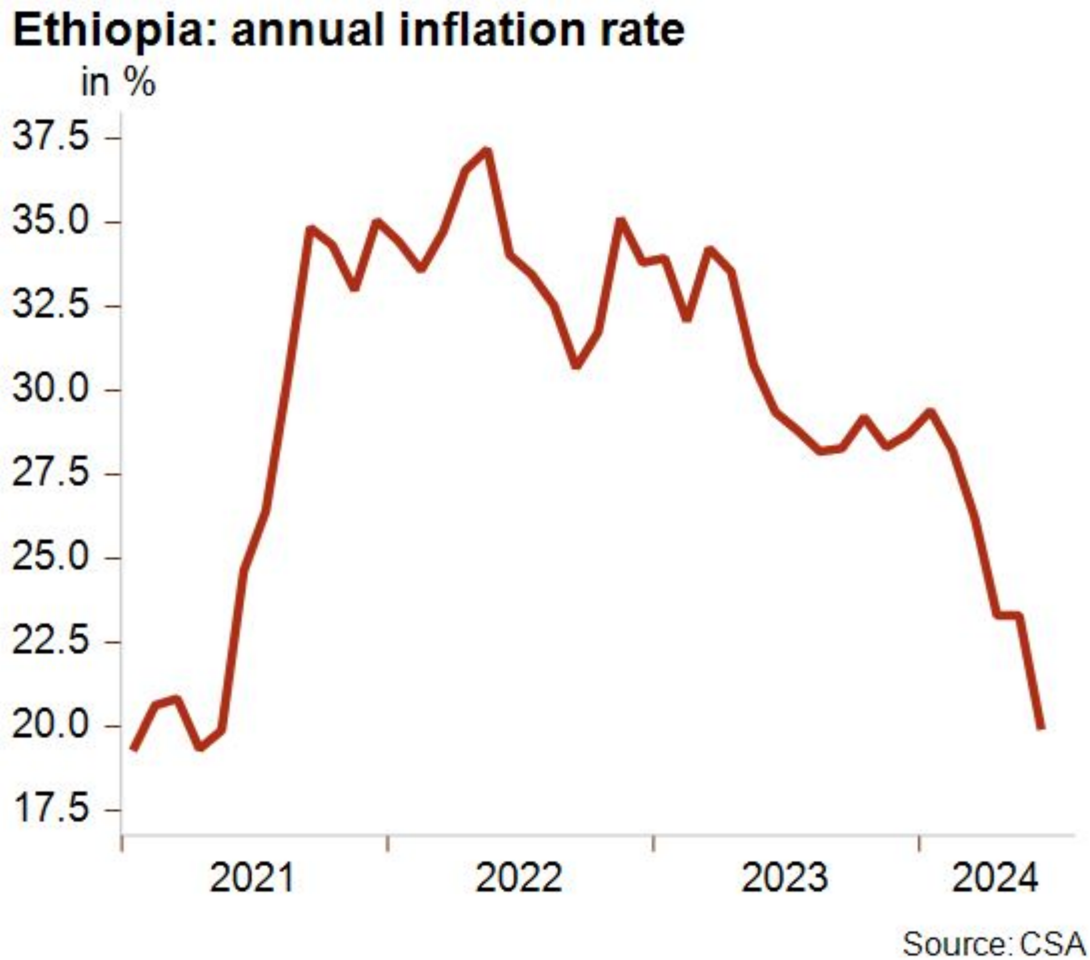
On 29 July, the Ethiopian central bank introduced a floating exchange rate regime, which led to a sharp depreciation of the birr (see graph below). The same day, the IMF Board approved an Extended Credit Facility (ECF) arrangement of about USD 3.4 billion, with a USD 1 billion immediate disbursement. The World Bank followed the IMF announcement with the pledge of USD 16.6 billion of funding over the next three years, including a USD 1 billion IDA grant and a USD 500 million concessional loan.



Impact

The East African country’s previous exchange rate system based on central bank-determined exchange rates and current account restrictions had contributed to severe foreign exchange shortages, weak export growth, high inflation, the overvaluation of the Ethiopian birr and the establishment of a parallel market where the birr traded at more than twice its official rate.

Ethiopian authorities had been reluctant to float the birr, worrying about its expected depreciation and the economic and political repercussions it would bring. One of the main concerns being inflation – which is already at a very high level despite a recent moderation (as shown on the graph below) – given its link with the cost of living and the risk of social unrest.



Ethiopia's move towards a floating exchange rate, the removal of current account restrictions and the adoption of a four-year IMF programme are significant positive developments. They should help alleviate chronic foreign exchange shortages, increase foreign exchange reserves and restore macroeconomic stability. One of the key aspects relates to external debt sustainability. After all, in 2021, the authorities requested a debt restructuring under the G20's Common Framework. Progress was initially delayed by the civil war, which ended when the federal government and the Tigray People's Liberation Front (TPLF) signed a deal in late 2022. In August 2023, Ethiopia secured a debt payment suspension from China for loans maturing in the 2023-2024 fiscal year. A similar agreement was reached with Ethiopia's other bilateral creditors in November. The Paris Club announced a suspension of debt repayments until the end of 2024, contingent on Ethiopia reaching a preliminary bailout deal with the IMF by the end of March. However, after the IMF's visit to Ethiopia ended without a deal in early April 2024, the deadline lapsed, as did the extended deadline of 30 June. Now that a deal has finally been reached, the debt service suspension for Paris Club creditors is likely to remain in place for the rest of 2024. However, it should be noted that Ethiopia defaulted on a USD 33 million interest payment on its only Eurobond in December 2023, and that same USD 1 billion Eurobond will come due at the end of this year. This is not included in the debt service suspensions granted by official creditors but might be affected by the comparability of treatment principle in the case of a debt restructuring agreement.

The move towards a floating exchange rate and the IMF programme are very positive developments. In the very short term, it will alleviate foreign exchange shortages and should improve liquidity. In the longer term, a successful restructuring of the external debt, which is currently in distress, and the implementation of structural reforms should improve the solvency of the country. That being said, it is still too early to upgrade the short-term political risk and medium- to long-term political risk ratings (respectively in category 6/7 and 7/7) as it remains to be seen whether the authorities will be able to implement the difficult structural reforms in a challenging internal political situation and less supportive external environment.

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