Deloitte.

Invest in Ethiopia

Structural reforms set to unlock East Africa's largest economy

June 2019

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Country Overview

Ethiopia has averaged 9.9% real GDP growth between 2008 and 2018

Ethiopia has succeeded in becoming one of the world's fastest growing economies. The country recorded a real gross domestic product (GDP) growth rate of 7.5% in 2018, and has averaged 9.9% real GDP growth between 2008 and 2018, making it the fastest-growing economy in sub-Saharan Africa (SSA) and in the world.[1]

Despite the country's rapid economic expansion, it remains one of Africa's low income countries, with a GDP per capita of US$890.[2] As Africa's second most populated country, the agricultural sector employs over 65% of the population. The country aims to become a low middle-income country by 2025 and has implemented the Growth Transformation Plan II (GTP II) – its national plan for economic and structural transformation – towards realising its 2025 vision through a sustainable average real GDP growth of 11%.[3]

Economy

Although mainly known as an agriculturally dominated economy (and as a result vulnerable to weather conditions), agriculture has been eclipsed by Ethiopia's services sector. The industrial sector has been growing, and by 2025, Ethiopia is expected to become an industrial-based economy.

Ethiopia's employment structure, however, remains dominated by the agricultural sector. The sector leads in rural areas where over 70% of the country's population resides. Nationally, 66.2% of the population is employed in agriculture, 21.8% in services, and 12% in the industrial sector.[4]

The national poverty rate has declined substantially from 45% in 2000 to 24% in 2016,[5] however, inequality showed a modest increase, though it is lower than other African countries.[6]

Demographics

Ethiopia's population is expected to reach 126 million by 2025, from 107 million in 2018.[7] The country is still in its early stages of a demographic transition with a high dependency ratio of 78.8% and a working age population of 53.6%.[8] The transition is expected to change the country's population structure towards a working-age dominated structure – a boon for disposable income and economic growth. Given its favourable demographic conditions, as well as changing urban structure, these factors are expected to underpin a growing market size.

Ethiopia is Africa's second most populous country with a population of 107 million people

Political landscape

The ruling party, the Ethiopian People's Revolutionary Democratic Front (EPRDF), has been in power since 1991 and consists of four ethnic based political parties. The Federal Parliamentary Assembly elected the country's first female president Sahle-Work Zewde in 2018, following the unexpected resignation of Mulatu Teshome. The country currently operates as a federal parliamentary republic. Prime Minister Abiy Ahmed, who is also the head of state, announced plans to introduce a multiparty democracy. The next national elections are expected to be held in May 2020.[9]

Society

Ethiopia is a multi-ethnic country, with ethnic groups playing a major role in the country's political and economic power structures. The country has four major ethnic regions: Oromo people make up 34.4% of the country's population, followed by Amhara (27%), Somali (6.2%), Tigrinya (6.1%) and other (26.3%). The major religions in the country are: Ethiopian Orthodox (43.5% of the population), Muslim (33.9%), Protestant (18.5%), Traditional (2.7%) and other (1.4).[10]

Volatility

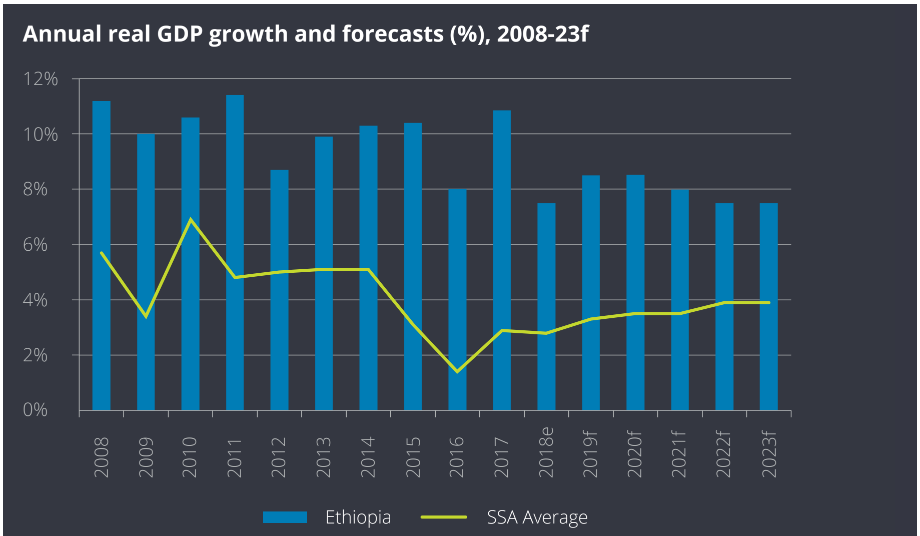
Ethiopia experienced civil unrests among the country's largest ethnic group, the Oromo in 2016-17. However, political transformation was seen in 2018 following the appointment of Prime Minister Abiy Ahmed. In the 2019 *Fragile States Index*,[11] Ethiopia was noted as the most improved country among all states. The country improved by 5.3 points, to a score of 94.2, and also improved its ranking to 23rd out of 173 countries.

Economic Environment

High growth has been supported by structural reforms

Over the 2008-18 period, Ethiopia has recorded an average real GDP growth rate of 9.9%, which makes it the fastest growing economy in SSA. This broad-based high growth rate has been supported by structural reforms that have been introduced through industrial sector development.

The implementation of these structural reforms have been boosted by government investment programmes as part of its Growth and Transformation Plan (GTP II), which is expected to run until 2020. Although growth has been commendable, real GDP growth has moderated to 7.5% in 2018.



Source: IMF, April 2019

Ethiopia's nominal GDP surpassed Kenya in 2015, making the former the largest economy in East Africa. Although the country's economy has performed well over the past few years, this growth has come from a low base.

Furthermore, the country remains vulnerable to exogenous shocks such as adverse weather conditions and dependence on state intervention. Even so, considering plans announced to implement further structural reforms, East Africa's largest economy is expected to retain its position as the fastest growing in SSA in the medium term, moderating from 8.5% in 2019-20 to 7.5% by 2023.[12]

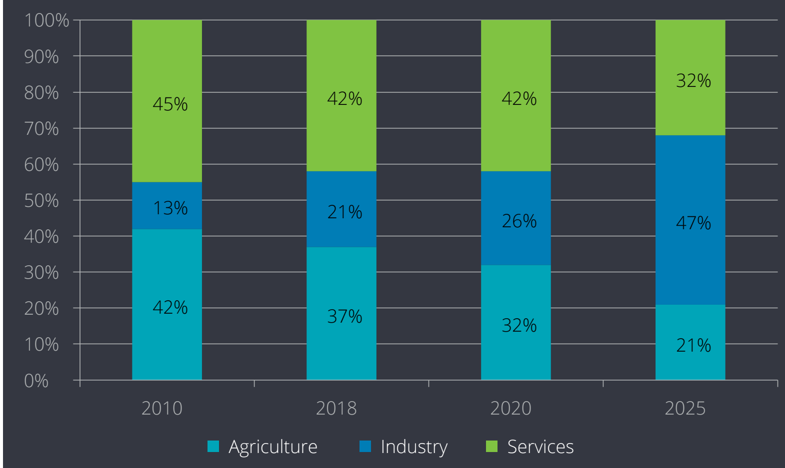
The industries sector is expected to become Ethiopia's largest GDP contributor by 2025

Sector composition

Ethiopia has shifted from being an agricultural-based economy to a services-driven one. The services sector accounts for 42% of GDP, followed by agriculture and industry at 32% and 26%, respectively.[13]

The industries sector has been the fastest growing sector over the past few years, owing to infrastructure developments. Industry is forecast to continue with this growth trajectory, accounting for 47% of GDP by 2025. These projections are expected to make the industries sector the largest GDP contributor, making Ethiopia an industrial-based economy. The services and agricultural sectors are forecast to account for 32% and 21%, respectively.

GDP value added (%), 2010*, 2018, 2020 and 2025



Source: United Nations, 2018

Note: Might not add to 100% due to rounding

Trade

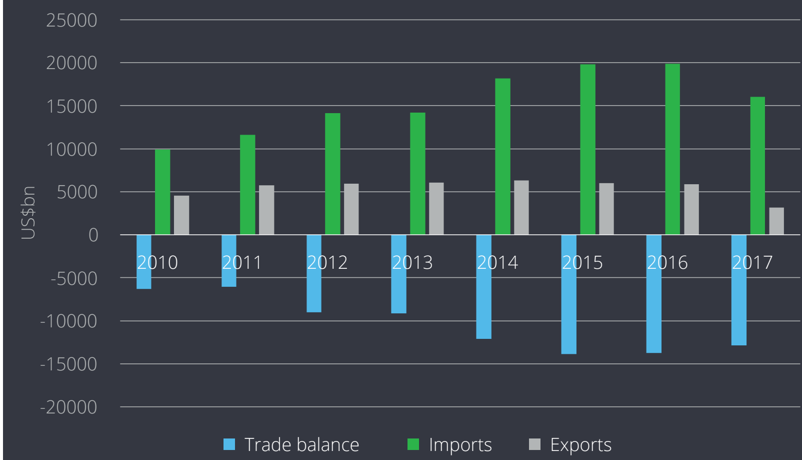
Ethiopia's total export basket is primarily dominated by agriculture and services. Merchandise exports increased from US$2.3bn in 2010 to US$3.2bn in 2017.[14] Coffee accounted for 29% of total exports, followed by oil seeds with 15%. In 2018, Ethiopia's top export markets by region were Asia (39.8%), Europe (28.7%), Africa (20.9%), America (9.9%), and Oceania (0.8%). The Ethio–Djibouti railway is expected to contribute towards regional integration and boost exports.

Total merchandise imports were recorded at US$16bn in 2017, up from US$8.6bn in 2010.[15] Ethiopia's largest import commodities were capital goods (34%), consumer goods (31%) and fuel (15%) in 2018.[16] Capital goods imports such as machinery and transport have been underpinned by ongoing major infrastructural projects.

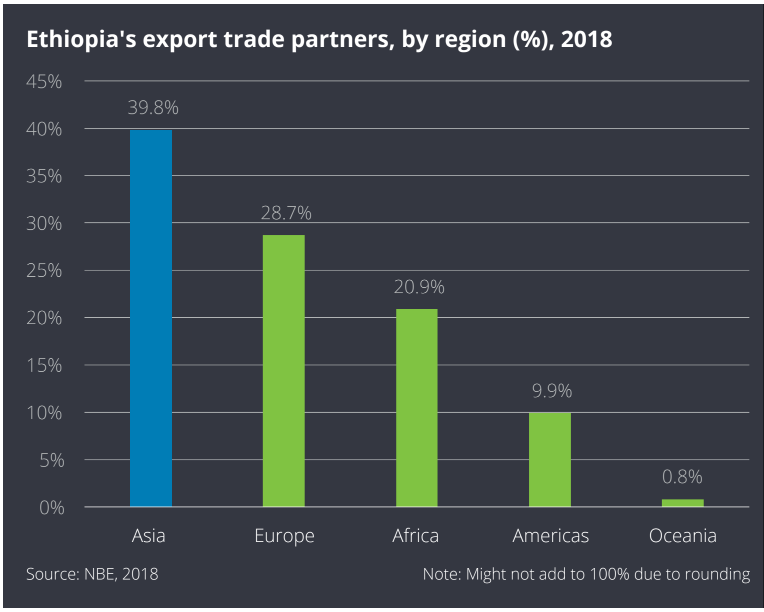
Despite its sizeable agricultural sector, adverse weather conditions have meant that Ethiopia still has a sizeable agricultural import bill. In the capital goods import basket, agricultural imports and industrial goods imports contribute about 0.3% and 26.8%, respectively.[17]

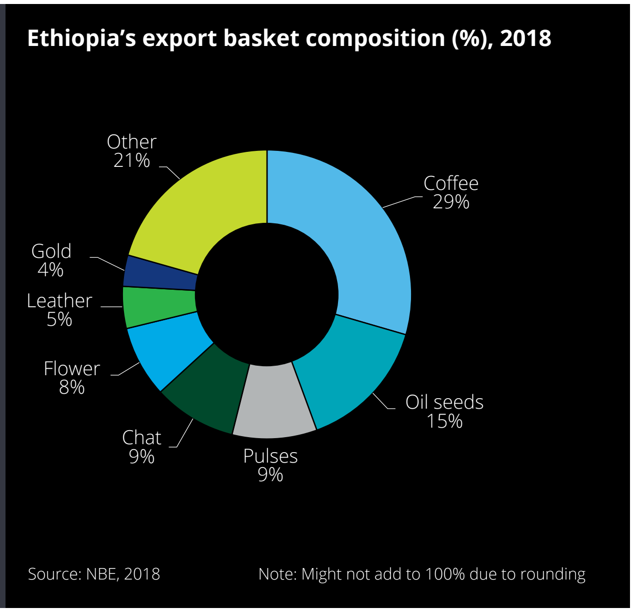
Over the years, Ethiopia has recorded a trade deficit, owing to low import substitution. The country's total trade deficit reached US$12.8bn in 2017 and due to its investment driven approach to growth, this trade deficit is expected to widen to US$13.9bn in 2020.[18]

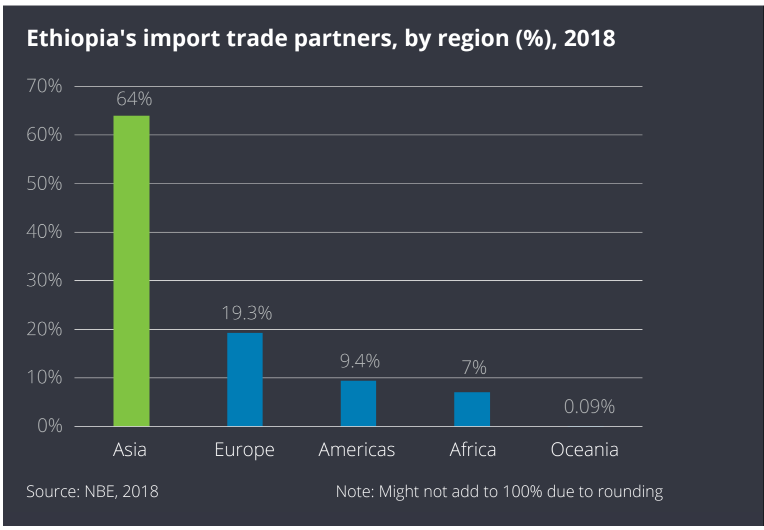
Ethiopia's merchandise goods exports, imports and trade balance (US$bn), 2010-17

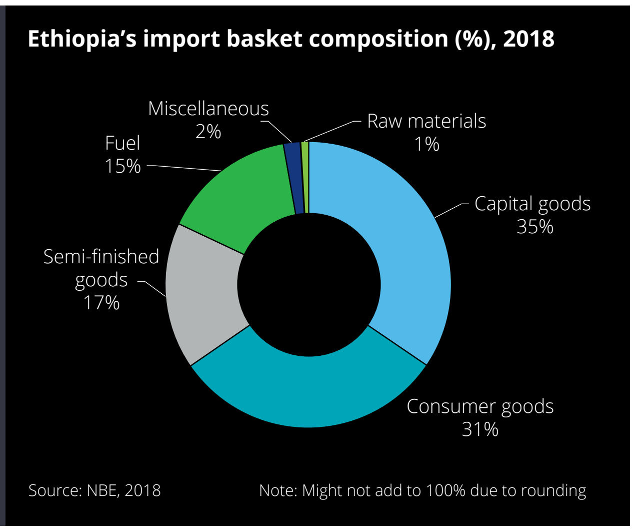


Source: UNCTAD, 2017


Ethiopia's export trade partners, by region (%), 2018
45%
40%
35%
30%
25%
20%
15%
10%
5%
0%
39.8%
28.7%
20.9%
9.9%
0.8%
Asia
Europe
Africa
Americas
Oceania
Source: NBE, 2018
Note: Might not add to 100% due to rounding


Ethiopia's export basket composition (%), 2018
Other
21%
Coffee
29%
Gold
4%
Leather
5%
Flower
8%
Oil seeds
15%
Chat
9%
Pulses
9%
Source: NBE, 2018
Note: Might not add to 100% due to rounding


Ethiopia's import trade partners, by region (%), 2018
70%
60%
50%
40%
30%
20%
10%
0%
64%
19.3%
9.4%
7%
0.09%
Asia
Europe
Americas
Africa
Oceania
Source: NBE, 2018
Note: Might not add to 100% due to rounding


Ethiopia's import basket composition (%), 2018
Miscellaneous
2%
Raw materials
1%
Fuel
15%
Capital goods
35%
Semi-finished
goods
17%
Consumer goods
31%
Source: NBE, 2018
Note: Might not add to 100% due to rounding

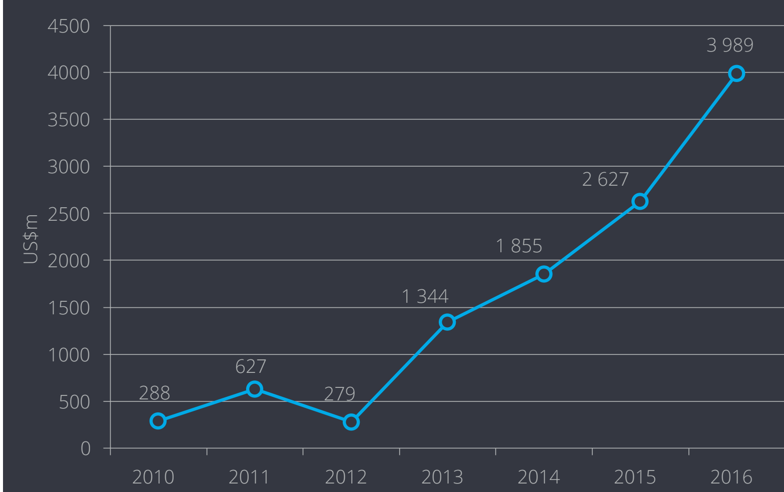
Ethiopia has become the second largest FDI recipient in Africa

Foreign direct investment (FDI)

Ethiopia has maintained strong investor interest as one of the top investor destinations in Africa. The country's FDI inflows have increased substantially throughout the years: from US$288m in 2010 to a record high of US$3.6bn in 2017. This has made Ethiopia the second largest FDI recipient in Africa, with China being the largest investor.

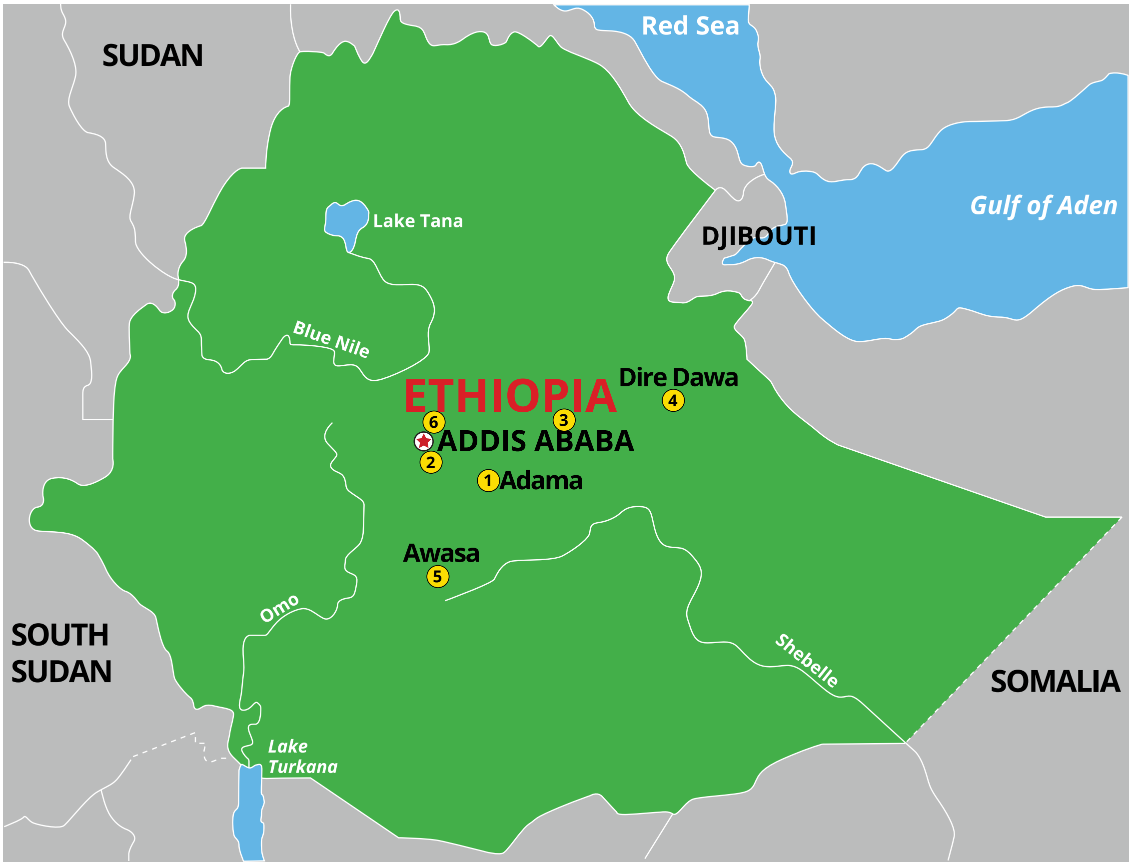
Since 2013, FDI inflows have doubled, primarily boosted by investments in manufacturing, industrial parks and large infrastructural projects such as the Great Renaissance Dam and the Modjo-Hawassa highway. Investments can be expected to remain inflated considering the country's infrastructural plans and the creation of multiple special economic zones (SEZs). Another factor which is expected to fuel investments is the recent launch of the African Continental Free Trade Area (AfCFTA) which aims to boost economic integration and intra-Africa trade by 60% within three years.

FDI inflows (US$m), 2010-16



Source: UNCTAD, 2017

Ethiopia's Special Economic Zones, 2019



Source: Ethiopian Investment Commission, 2019

01 **Adama Industrial Park**
Cluster: Textiles
Status: In operation

02 **Bole Lemi Phase II**
Cluster: Textiles & apparel, Leather
Status: Upcoming

03 **Debre-Birhan Industry Park**
Cluster: Textiles & garments, agro-processing
Status: Upcoming

04 **Dire Dawa Industrial Park**
Cluster: Multiple sectors (Heavy industries, textiles, vehicle assembly, food & processing, chemicals
Status: Upcoming

05 **Hawassa Industrial Park**
Cluster: Textiles & garments
Status: In operation

06 **Kilinto Industrial Park**
Cluster: Pharmaceuticals
Status: Upcoming

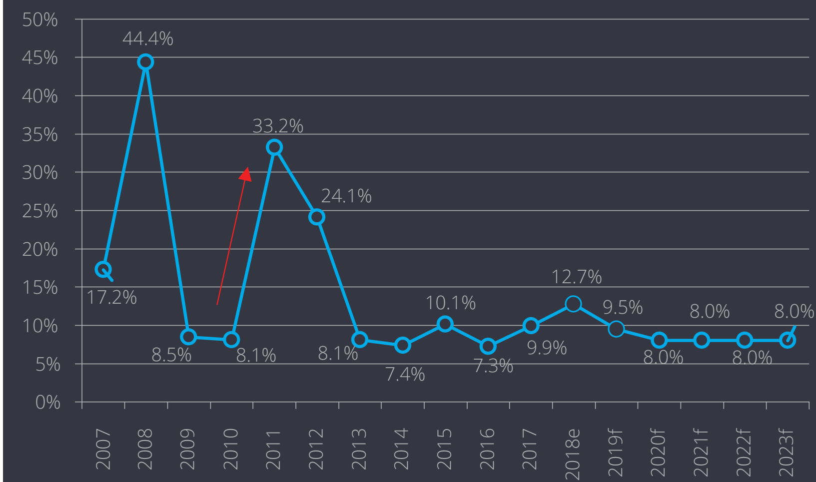
Inflation is forecast to decline to 9.5% by the end of 2019

Consumer price index (CPI)

The Ethiopian central bank uses monetary policy instruments to obtain the single digit inflation target of 8%. Ethiopia's vulnerable agricultural sector has experienced severe droughts, thus previously resulting in periods of soaring inflation. The country experienced an unpredictable CPI spike in 2011, where it trended around 33% following the severe drought and the devaluation of the local currency, the Ethiopian birr, in 2010.[19]

Inflation is expected to average 9.5% in 2019, down from 12.7% in 2018 reflecting the decline in global food prices.[20] Thereafter, a strengthening of key international commodity prices, coupled with currency depreciation, will steadily push up inflation to an average of 8% in 2021. Given that price trends in Ethiopia are strongly influenced by the primary harvest, there remains a moderate risk that inflation will be substantially higher if unfavourable weather conditions lead to food shortages.

CPI annual average (%), 2007-23f



Source: IMF, 2019

Banking

Ethiopia has a highly regulated financial system. The banking system remains underdeveloped, coupled with restrictions in foreign participation in certain financial sectors. The banking sector continues to be dominated by state-owned financial institutions. The Commercial Bank of Ethiopia, which is the largest player in terms of assets and deposits, accounts for 47.7% of loans. In 2011, a directive was issued by the National Bank of Ethiopia (NBE), where private banks are expected to invest worth 27% of their lending NBE bond. Proceeds will be used to support the Development Bank of Ethiopia in funding loans directed towards the large sectors.

Currency

The devaluation of the birr continues to remain a concern. This is mainly due to the currency's likeliness to drive inflationary pressures. Ethiopia currently uses a floating exchange rate system. Throughout the years, the birr has been fairly stable until the Ethiopian government came to a decision to devalue the currency by 15% in 2017 to boost export competition. This was the first major devaluation since 2010.

The Ethiopian currency is expected to depreciate steadily further in the coming years owing to a decline in inflation and a high trade deficit. The birr is forecast to weaken to an average of ETB33.78/US$1 from ETB27.4/US$1.[21]

Foreign reserves were recorded at US$2.8bn in 2018, down from US$3.2bn in 2015.[22] Ethiopia's foreign reserves are mainly from donor support, remittances and exports. Import and export traders have been permitted to retain up to 30% of their revenue in foreign currency, creating the opportunity to obtain foreign currency to finance imports.[23] The limit has improved from 10%.

Ethiopia's strict foreign currency regime makes it challenging to convert the birr in other countries and additionally limits the foreign currency holding amount within local borders to a maximum of 30 days.[24] The country also experiences foreign exchange shortages, owing to high demand for local currency. The reported currency shortage is expected to continue for a few more years, however, privatisation is expected to help resolve the challenge.[25]

Business Environment

Ethiopia ranks 159th out of 190 countries in the World Bank's *Ease of Doing Business Index*

While recording robust growth rates and improved FDI inflows, Ethiopia continues to come across drawbacks in doing business and competitiveness. The World Bank's 2019 *Ease of Doing Business Report* highlighted a list of factors hindering competitiveness. These include stringent customs, administrative procedures and other challenges such as high logistics costs, access to credit and foreign exchange. These challenges are predominantly burdensome to small and medium-sized enterprises (SMEs). The report further ranked Ethiopia among the countries with the least favourable business environment in the world.

The process of starting a business has been a challenge throughout the years. However, the country is looking into improving doing business by speeding up the process of obtaining construction permits and through the ongoing GTP II. The GTP II in particular stresses the need for global private sector competitiveness and improving FDI inflows.[26]

Ethiopia has further plans to open up the market through the implementation of policy reforms, such as privatising leading state-owned and public-private partnership (PPP) infrastructural projects. With improvements in the business climate still to materialise, the country currently ranks a low 159th out of 190 countries in the World Bank's 2019 rankings.[27]

Ethiopia records one of the highest gross fixed capital formation as a share of GDP rates

Infrastructure and logistics

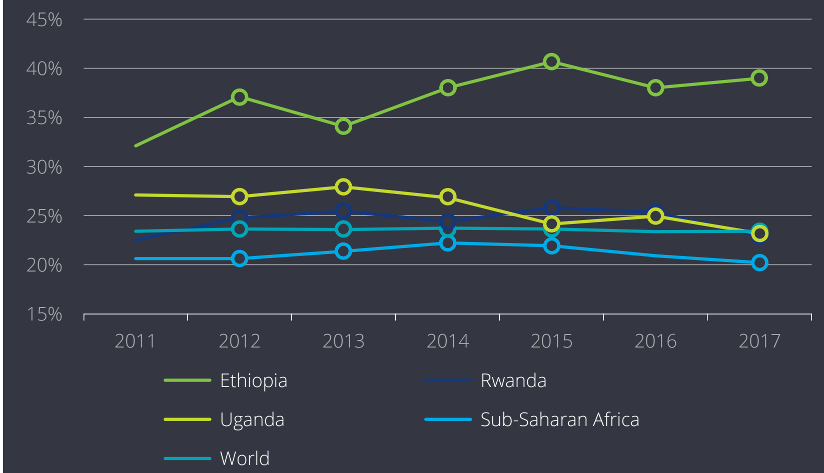
Throughout the years, Ethiopia has developed its infrastructure largely through public investments and close collaborations with Chinese firms and banks. This is recognised through Ethiopia's collaboration with two Chinese firms and financial support from the Export-Import Bank of China (China EXIM Bank), to build the first electric-powered railway in Africa.

The railway is expected to contribute towards industrialisation and create a favourable business environment for Ethiopia considering the country's experience with infrastructural bottlenecks. Indeed, Ethiopia continues to encounter logistics constraints. In the World Bank's 2016 *Logistics Performance Index*, the country ranked 126th out of 160 countries. The ranking remains below SSA's top performer, South Africa, which was ranked 20th out of 160 countries.[28]

As a landlocked nation, Ethiopia relies on the port of Djibouti, located 1 000km away for trade flows. This poses the need for reliable domestic transport and logistics networks. The country's public infrastructure investments are expected to ease these bottlenecks. These include plans to diversify its maritime trade route and develop physical infrastructure to improve its logistics channel.

The GTP II supports the significance of infrastructure development. Under the GTP II, the country has invested an estimated US$75bn. As a result, Ethiopia has one of the world's highest gross fixed capital formation (GFCF) rates as a share of GDP. The country spent 39% of GDP on land improvements, machinery and equipment purchases and construction of roads and railways in 2018. GFCF is forecast to reach 38.3% in 2023.[29]

GFCF as a share of GDP (%), 2011-17



Source: World Bank, 2018

Tax Administration[30]

Tax is administered in Ethiopia by the Revenue and Customs Authority.

Corporations

1. Tax year – The taxable period is the accounting period.

2. Consolidated returns – Consolidated returns are not permitted; each company must file a separate return.

3. Filing and payment – The tax return must be filed within four months after the end of the accounting period.

4. Penalties – Penalties are imposed for late filing, failure to file or understating income. Penalties range from administration penalties such as financial fines, to criminal penalties such as imprisonment on those who do not comply with the regulations. The administrative penalty includes the sell or seizure of taxpayer's property and pays the tax. The criminal penalty includes imprisonment and a fine.

5. Rulings – There is no provision for advance rulings under Ethiopian tax legislation.

Individuals

1. Tax year – The tax year runs from 8 July to the following 7 July.

2. Tax filing – Each taxpayer must file a return. Spouses are not permitted to file joint returns.

3. Filing and payment – A pay-as-you-earn (PAYE) system is used for employment income, under which the employer withholds tax on the individual's wages. An individual is required to file if he/she derives any other income from employment.

4. Penalties – Penalties are imposed for late filing, failure to file or understating income. Penalties for failure to pay tax may take the form of administrative penalties, including the sale or seizure of the taxpayer's property to pay the tax due; or criminal penalties, including imprisonment and a fine.

Value added tax

1. Filing and payment – Returns must be filed and the tax due paid on a monthly basis.

2. Penalties – Penalties are imposed for failure to register for VAT, issuance of tax invoices when not registered, issuance of incorrect tax invoices and failure to issue a VAT tax invoice. Penalties range from administration penalties such as financial fines, to criminal penalties such as imprisonment on those who do not comply with the regulations.

Withholding Tax (WHT)

The WHT rates on various types of payment are as follows:

Payment	Residents	Non-residents
Dividends	10%	10%
Interest on deposits	5%	10%
Royalties	5%	5%

Tax Treaties

Ethiopia has concluded tax treaties with the following countries. The treaties with Kuwait and Russia are not yet in force:

Country	Dividends	Interest	Royalties
China (PRC)	5%	7%	5%
Cyprus	5%	5%	5%
Czech Republic	10%	10%	10%
France	10%	5%	7.5%
India	7.5%	10%	10%
Ireland	5%	5%	5%
Israel	5%/10%/15%	5%/10%	5%
Italy	10%	10%	20%
Korea (ROK)	5%/8%	7.5%	5%
Kuwait	0%/5%	0%/5%	30%
Netherlands	5%/10%	5%	5%
Portugal	5%/10%	10%	5%
Romania	10%	15%	15%
Russia	5%	5%	15%
Saudi Arabia	5%	5%	7.5%
Singapore	5%	5%	5%
South Africa	10%	8%	20%
Tunisia	5%	11%	5%
Turkey	10%	10%	10%
United Kingdom	10%/15%	5%	7.5%

Income Tax – Individuals

Employment income

Taxable income (ETB)	Rate	Deduction (ETB)
0 – 600	0%	0
601 – 1 650	10%	60
1 651 – 3 200	15%	142.5
3 201 – 5 250	20%	302.5
5 251 – 7 800	25%	565
7 801 – 10 900	30%	955
Over 10 900	35%	1 500

Note: ETB: Ethiopian birr

Rental income

Only rental income derived from the lease of buildings by Ethiopian residents is taxed under this schedule. The tax applies to income from the rental of buildings, including amounts received attributable to furniture and equipment where premises are let furnished. For individuals, rates are progressive up to a maximum of 35%.

Business income

Unincorporated businesses and sole traders are taxed as follows:

Taxable business

Income (ETB)	Rate	Deduction (ETB)
0 – 7 200	Exempt threshold	0
7 201 – 19 400	10%	720
19 401 – 38 400	15%	1 710
38 401 – 63 600	20%	3 630
63 601 – 93 600	25%	6 780
93 601 – 130 800	30%	11 460
Over 130 800	35%	18 000

Note: ETB: Ethiopian birr

Income Tax – Companies

Companies	Rate
Standard corporate tax (non-mining companies)	30%
Large scale mining companies tax	25%

The difference between large-scale and small-scale mining is based on the amount of estimated reserve, not by turnover.

Anti-avoidance

Transfer pricing

Transfer pricing legislation regulates cross-border transactions involving goods or services between related parties. The rules allow the Revenue and Customs Authority to disallow certain expenditure or adjust income if the contract price is less or more than the arm’s length price.

Thin capitalisation

If a foreign-controlled resident company, other than a financial institution, has an average debt to average equity ratio in excess of 2:1 for a tax year, no deduction is available for the interest paid by the company during that year on the portion of the loan that exceeds the prescribed threshold.

Controlled foreign resident company (CFRC)

CFRC means a resident company in which more than 50% of the membership interests in the company are held by a non-resident either or together with a related person or persons.

Social security

The employer must contribute to the social security scheme on behalf of the employee at a rate of 7% of basic salary. The employee's contribution is 11%.

Indirect Taxes

Value Added Tax (VAT)

VAT	Rate
Standard Rate	15%

Turnover tax

Turnover tax is levied at a rate of 2% on goods sold locally and contractor services; and 10% in other cases.

Customs and import duties

Ethiopia is a member of the Customs Cooperation Council. Ethiopia has reduced customs duties on a wide range of imports and duties are levied at rates ranging from 0% to 35%. Rates on category one goods (e.g. raw materials, semi-finished goods, producers' goods, and items imported for public use such as minibuses, buses etc.) range from 0% to 10%. The rates are 20% to 35% for category two goods (consumer or finished goods imported for personal use or for a non-productive purpose). Visitors are allowed to import items up to a specified value duty-free.

Excise tax applies on a variety of goods. All importers and exporters must be registered with the Ministry of Trade and obtain a trading license. The ministry regulates imports. Foreign exchange permits are required for all importers. Highly protective tariffs are applied on certain items such as textile products, leather goods etc., to protect local industries.

Other Taxes

Stamp duty

The following instruments are subject to stamp duty:

- Memoranda and articles of association of a business organisation, cooperative or any other form of association
- Awards, bonds and warehouse bonds
- Contracts, agreements and memoranda
- Security deeds
- Collective agreements
- Contracts of employment
- Leases, including sub-leases and transfers of similar rights
- Notarial acts
- Powers of attorney and documents of title to property.

Tax on gains from transfer of certain investment property

Gains arising from the transfer (i.e. sale or gift) of a building held for commercial purposes are taxable at 15%. Gains arising from the transfer of shares are taxed at 30%.

Gains arising from the transfer of a residential property are exempt from tax provided the building is fully occupied for residential purposes for two years before the date of transfer. Any person authorised by law to accept, register, or in any way approve the transfer of capital assets may not do so before ascertaining that the payment of the tax has been made.

Land use tax

The regional states have their own land use rent systems, with rates differing depending on the region.

General Investment Information

Investment incentives[31]

Ethiopia's Investment Code provides incentives for development-related investments, reduces capital entry requirements for joint ventures, permits the duty-free import of capital goods (except computers and vehicles), opens the real estate sector to foreign investors, extends the relief for losses carried forward and gives priority to investors for the lease of land.

Certain sectors are, however, reserved to domestic investors. These include broadcasting, retail and wholesale trade (except in petroleum and locally produced goods), import trade, export trade of local agricultural products, small and medium-scale construction, bars and nightclubs, small hotels and restaurants, travel agencies, car and taxi services, bakery products, grinding mills, barber shops and beauty salons, goldsmith shops, tailoring services, building and vehicle maintenance services, saw-milling, customs clearance, museums and theatres, and printing.

The government reviews investment proposals in a non-discriminatory manner; the screening process is not regarded as an impediment to investment, a limit to competition or a means of protecting domestic interests.

There are no discriminatory or excessively onerous visa, residence or work permit requirements applicable to foreign investors.

Key investment incentives include: [32]

- Customs duty exemptions of up to 100% on imports of capital goods for eligible areas of investment;
- Income tax exemptions for a period ranging between one and nine years, depending on the specific activity and the location of the investor;
- Loss carry forward for businesses that suffer losses during the income tax exemption period for half of the tax exemption period;
- No levy on certain Ethiopian export products;
- Duty Drawback Scheme, Voucher Scheme & Bonded Factory and Manufacturing Warehouse Schemes;
- Various non-fiscal incentives for exporters; and
- Guaranteed remittance of capital for foreign investors.

Exchange controls

All foreigners are required to open accounts denominated in Ethiopian birr with one of the commercial banks or authorised dealers or with special permission from the National Bank of Ethiopia. Credits to the accounts can be made only with foreign exchange receipts from abroad or checks from other similar accounts. Credits between two locally based accounts are not permitted. Checks from Ethiopian nationals, birr (cash) and funds from a locally paid working spouse may not be deposited without approval from the National Bank. International personnel may make payments for rent, air tickets, school fees and purchases from duty-free shops by check or in cash.

Foreigners may remit limited funds abroad from their earnings deposited in local accounts after the deduction of what is considered a reasonable amount for local living expenses. Such cases are considered individually. Foreign currency may be drawn on presentation of a confirmed air ticket for international travel. On final departure from Ethiopia, the balance in the account may be converted into foreign currency upon presentation of evidence to the National Bank as to how the remaining funds were acquired.

Unlocking Ethiopia's Growth Potential

Sectors to watch

- Automotive industry
- Power infrastructure
- Agriculture
- Construction

Prime Minister Abiy Ahmed has announced numerous reform plans, including plans to loosen the state's dominance in key sectors, in efforts to attract investor interest and boost growth. This has included plans to privatise four state-owned enterprises: Ethiopian Airlines, Ethio Telecom, Ethiopian Electric Power Corporation, and Ethiopian Shipping & Logistics Services Enterprises.[33] The telecommunications firm is expected to be the first company to be privatised. These sectors can be expected to boost foreign investments in the medium term.

Ethiopia has demonstrated a commitment towards SEZs through the expansion of government and private-led industrial parks, while private led SEZs are predominantly funded through Chinese investments.

Other sector opportunities are in:

Manufacturing: Investment opportunities continue to exist in the manufacturing sector. This is recognised through increasing investments from foreign investors, mainly in light manufacturing (textile and garment, leather, agro-industry, electronics). Numerous Chinese and Indian manufacturing companies have moved their manufacturing plants to Ethiopia to position themselves closer to their textile raw material source.

Logistics: The logistics sector carries investment opportunities following the Ethiopian Investment Commission's decision to remove regulations which previously restricted foreign investors from investing in the country's logistics sector.

Pharmaceuticals: As a country with the second largest population in Africa, demand for pharmaceutical products is expected to increase with increased disposable income expected to boost spending on such products.

Automotive industry

Ethiopia's automotive industry presents a long-term opportunity for first movers

With its limited automotive manufacturing capacity, Ethiopia continues to import from various countries typically through the port of Djibouti. In the past year, Ethiopia imported US$1.5bn (10% of imports) worth of automotive products, including car parts, spares and accessories.[34] Used vehicle imports dominate the market, accounting for 85% of the used vehicles market. These vehicles are often ten years old or more, which is much higher than the global average age of four years.[35]

Passenger vehicles account for the largest share of vehicle imports, making up 84% of the automotive market, while commercial vehicles only make up 16%.[36] Although passenger vehicles are the most expensive vehicle imports, growth is expected to contract, while commercial vehicles are expected to expand in the coming years, owing to infrastructure development projects.[37] New vehicles remain unaffordable for most Ethiopians, considering the low disposable income, absence of vehicle finance and high import taxes. Given the higher demand for used vehicles, there is also a high demand for spare parts and accessories.[38]

Ethiopia's motor vehicle manufacturing is limited to assembly, manufacturing of vehicles and small-scale manufacturing of parts and accessories. In efforts to expand the automotive manufacturing industry, Ethiopia launched a vehicle manufacturing and assembly plant, Bishoftu Automotive Industry (BAI). The plant is located at a military base, which forms part of the Ethiopian military. The BAI specialises in assembling, overhauling and localising vehicles.[39]

The country's vehicle assembly market is mostly occupied by Chinese brands, such as Geely, FAW and Li Fan, assembled by locally-based manufacturers.[40] Currently with an active small-scale domestic industry, Ethiopia aspires to become Africa's largest car manufacturer through tariff protection and by increasing the number of local assemblers with extensive support from Chinese companies.

Domestic assemblers			
Assembler	**Annual capacity**	**Brand**	**Vechile type**
Automotive Manufacturing Co of Ethopia (AMCE)	600	IVECO	HCV
Belayab	3 500	FAW, Kia	HCV, PV
Betret International Engineering	1 200	BYD Auto	PV
Bishoftu Automotive Industry (BAI)	4 000	Bishoftu, FAW	PV, LCV, HCV
Mesfin Industrial Engineering	2 200	Geely, Peugoet, Sonalika	PV
Nigma Motors And ZAZ	300	Nigma (produces Daewoo, and Chevrolet under licence)	PV
Yang Fan	5 000	Lifan	PV
Marathon Motors	2 500	Hyundai	CV

Source: Deloitte Africa Automotive Insights; Fitch Solutions, 2019
Note: HCV: Heavy commercial vehicle; PV: Passenger vehicle; LCV: Light commercial vehicle

Ethiopia's vehicle production (10 000 units a year) is still in its developing stage and one of the lowest in the world.[41] However, production has increased recently, due to local assembly investments such as Hyundai's first assembly plant launched in Addis Ababa at the beginning of 2019.[42] In efforts to develop the automotive industry, the government of Ethiopia recently became the third country in SSA to sign a memorandum of understanding (MoU) with Volkswagen which seeks to seize opportunities in vehicle assembly facilities and localising automotive components in Ethiopia.[43]

Ethiopia - Tax rates for vehicle imports (%)					
	Customs duty	**Excise tax**	**Surtax**	**VAT**	**With-holding Tax**
Cylinder capacity 1 000-1 300cc	35	30	10	15	3
Cylinder capacity 1 301-1 800cc	35	60	10	15	3
Cylinder capacity 1 801-3 000cc	35	100	10	15	3
Cylinder capacity >3 000cc	35	100	10	15	3
C-cabin and single cabin, carrying capacity not exceeding 1 500kg	35	0	0	15	3
Public transport - seating capacity ≤ 15 passengers	35	0	0	15	3
Public transport - seating capacity > 15 passengers	10	0	0	15	3
Truck	10	0	0	15	3

Source: Ethiopia Revenue and Customs Authority; Fitch Solutions, 2019

Ethiopia has a growing middle class. This will see the demand for motor vehicles growing in the coming years. Although value chain participation is limited and no targeted policies have been put in place yet, the government has recognised the significance of attracting vehicle assembling multinational corporations in the industry[44] and is creating a sustainable platform for long-term foreign investment. The country's underdeveloped market should be identified as a long-term opportunity for first movers who seek to position themselves in the East African and broader African automotive market.

Power infrastructure

The Grand Ethiopian Renaissance Dam is projected to be Africa's largest hydropower plant

Ethiopia has the second highest electricity generation capacity in SSA after South Africa, at 4 206 MW. This is thanks to the country's abundant natural resources and well-developed transmission infrastructure. Natural resource availability offers abundant capabilities to cater for the country's power needs. These include wind, solar and geothermal. Approximately 89% (3 743 MW) of the installed generation capacity comes from hydropower, while 8% (337 MW) and 3% (126 MW) come from wind and geothermal, respectively.[45] Even with the large energy potential, Ethiopia struggles to meet the growing electricity demand of the country's large population.

About 60% of the country's population has no access to electricity and where there is grid coverage, only 60% of households are connected. About 85% of the urban population has access to electricity while only 29% of the rural population has access.[46] The country continues to experience energy shortages due to a drop in water levels in hydroelectric dams. This has resulted in a suspension of energy exports to neighbouring Djibouti and Sudan.[47]

The Ethiopian government strives to expand various power generating projects in efforts to deliver reliable electricity. A National Electrification Programme (NEP) was launched in 2017 to ensure that 65% of the population has access to electricity through the grid and 35% through off-grid technologies by 2025.[48] Once completed, the Grand Ethiopian Renaissance Dam (GERD) is expected to be the largest hydropower plant in Africa and is further expected to generate 6 450 MW of electricity at full capacity.

Agriculture

Agro-economic zones are expected to support agricultural growth through investments

For many years, Ethiopia has been dependent on the agricultural sector. The sector currently accounts for 35% of total GDP, down from 52% recorded in 1990. As mentioned, the sector is highly dependent on rainfall, making it vulnerable to adverse weather conditions and drought. Due to erratic climatic conditions, the sector has experienced inconsistent growth throughout the years.

For example, the 2016 El Niño-induced drought was one of the worst in 30 years. The drought resulted in high famine conditions in most regions leaving about 10.2 million people in need of food assistance.[49] The south-eastern Somali region remains a concern as food insecurity continues to exist. About 1.8 million people in the region are food insecure.

Ethiopia's agricultural output is dominated by crop production (65%), followed by animal husbandry (26%), forestry (9%) and fishing (0.3%).[50]

Opportunities

Rising income levels: Urbanisation and economic growth have resulted in rising income levels, which in turn is resulting in changing consumer tastes. Consumer tastes have shifted throughout the years, thus leading to, for example, higher wheat consumption. With income levels expected to rise further in the coming years, owing to the upcoming demographic transition, demand for high quality processed wheat products can be expected.

Special Economic Zones (SEZs) and special agro-economic zones: As part of the government's efforts to attract investment in the agricultural sector, various SEZs and special agro-economic zones are being created. Many of the SEZs are devoted solely to agro-processing operations and offer a variety of attractive investment incentives. These include tax holidays, preferential access to export markets (in some cases) and tax free imports of capital goods.[51]

Integrated agro-industrial parks: The Ethiopian government is presently leading an integrated agro-industrial parks initiative which aims to promote agricultural commercialisation.[52]

Agricultural Growth Programme (AGP II): The programme formed under the GTP II aims to increase agricultural productivity and smallholder farmers' agricultural commercialisation. This is set to be done through research, public support services, irrigation and value chain schemes.[53]

Coffee

As the sixth largest coffee producer in the world, Ethiopia accounts for 4% of global coffee production and 40% of Africa's total coffee production. Coffee production is closely linked with its cultural and historical identity and contributes a sizable proportion (29%) towards Ethiopia's total exports.[54] Ethiopia is home to Arabica coffee, located in the south-eastern and south-western parts of the country. Although coffee production has increased over the years, the sector continues to confront numerous setbacks such as high temperatures and adverse weather conditions.

Wheat

As the largest wheat producer in SSA, Ethiopia continues to experience drought and market imperfections. Wheat is solely rain-fed and leaving it vulnerable to harsh weather conditions. These challenges have resulted in dependence on wheat imports to meet local demand. Wheat accounts for 52% of the total agricultural imports and contributes to the country's trade deficit.[55] Wheat production has been on a growth trajectory, however, consumption, currently estimated at 6 million metric tonnes, has surpassed production (4.2 million metric tonnes). Consumption is forecast to remain at 6 million metric tonnes in 2019, while wheat imports are projected to reach 1.7 million metric tonnes.[56]

Construction

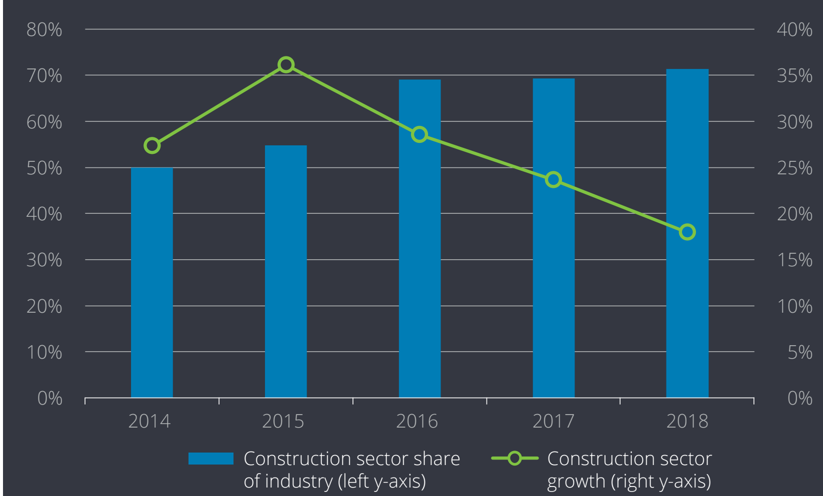
Construction activities account for 71.4% of the industries sector

Over the years, the construction sector has recorded robust growth, owing to public infrastructure expenditure. The sector expanded by an annual average of 30% for the past five years, predominantly driven by projects related to road, railway, dam and residential expansion. The sector has been performing well, it has however expanded by 16% in 2018, which is below the five-year average of 30%.[57] Construction currently accounts for 71.4% of the industries sector, making it the largest industrial activity in Ethiopia.[58]

As per Deloitte's 2018 *Africa Construction Trends report*, Ethiopia had the third largest number of construction projects underway in Africa, after Egypt and Kenya. The report, which tracks projects that had broken ground and are under construction, and valued at US$50m or more, found that 38 projects were under construction, valued at US$19.1bn.[59]

Ethiopia is set to be the fastest growing construction market in SSA,[60] based on upcoming development plans. These additional construction plans are expected to boost infrastructure and stimulate the country's international competitiveness. At present, 22% of total investment projects are focused on construction activities. So too, the construction industry's share of GDP is projected to expand, however at a slowing rate, accounting for 19.2% of GDP by 2023.[61]

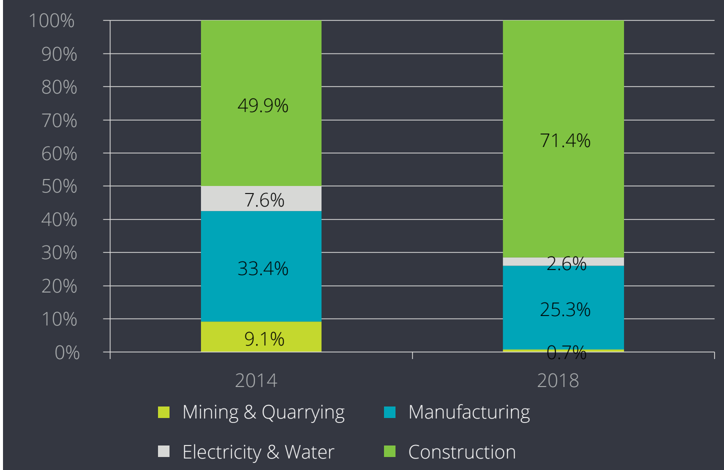
Construction sector (%), 2014-18



Source: NBE, 2018

Although growth is expected to moderate, opportunities continue to exist considering state efforts to diversify the industrial base and improve logistics networks.

Construction as a share of industry (%), 2018



Source: NBE, 2018

Construction projects underway	Value (US$)	Industry
The Grand Renaissance Ethiopian Dam	US$4.8bn	Energy & power
Koysha Hydroelectric Dam	US$2.8bn	Energy & power
Corbetti Geothermal Project	US$2bn	Energy & power
Awash-Woldia/Hara Gebeya Rail Project	US$1.7bn	Transport

Source: Deloitte Africa Construction Trends, 2018


ERITREA
YEMEN
DJIBOUTI
Aden
Gulf of Aden
ETHIOPIA
Addis Abada
Berbera
Jima
Mega
L. Turkana
Eyl
SOMALIA
Obbia

Risks for Investors

Ethiopia exports 90% of goods through the Djibouti port

Insecurity

Ethiopia continues to face ethnocentric conflicts and political instability. Political insecurity has intensified across various regions of the country, causing communal violence among multiple ethnic groups. This has been seen in the recent alleged coup attempt against the Amhara regional government. The brutal attack which left the regional President, Ambachew Mekonnen, army chief of staff, and two senior regional political figures shot dead highlights the country's political insecurity[62], thus leaving the Prime Minister's reform plans under threat. Despite the Prime Minister's implementation of political reforms ethnic dominance and political insecurity remain common. Analysts suggest thorough preparation by the Prime Minister for possible ethnic tensions as the 2020 national elections approach.[63]

Landlocked country

Ethiopia is a landlocked country and relies heavily on Djibouti for export trade. About 90% of Ethiopia's exports are transported through the port of Djibouti. Despite the state's efforts to diversify the transport industry by investing in rail and road projects, the logistics industry still has plenty of room for improvement. Ethiopia has recognised the need to diversify its logistics industry and has therefore confirmed plans to open up the logistics sector through private sector participation.

Adverse weather conditions

The agricultural sector relies heavily on rain fed crops. These crops remain vulnerable to weather extremes and poor quality soil. As the sector is still one of the most significant in Ethiopia, these adverse weather conditions have an unfavourable impact on crop production, therefore posing risk on the economy's food prices and may place a burden on the population.

Currency risk

Ethiopia remains one of the biggest foreign aid receivers in Africa in foreign currency terms.[64] However, foreign aid has largely contributed towards the country's development. External financing is mainly granted through foreign currency, while import tariffs are charged based on the local currency. This poses currency devaluation risks which may result in lower investment project proceeds and may possibly affect investments.[65]

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