Financing Industrialization and Transformation in Ethiopia

Gaps and Limitations with Policy Implications

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Economy

- Rapid but slowing demand-led growth since 2004/05 (6% in 2020/21)
- Largely government **investment led**
- Construction and Trade have been leading
- However the share of agriculture in the Economy dropped from 50% to 36.4%
- While it still hosts more than 70% of labour force

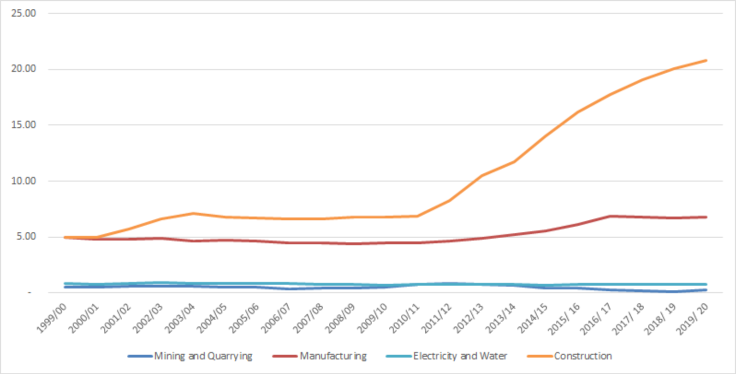
Macro Imbalance

- High inflation
- High external debt
- severe forex shortage
- Financial repression and fiscal imprudence
- **worsened by pandemic and conflict**

Similar Story when looking at Industry

- Manufacturing, Construction, Mining and Quarrying, Electricity and Water
- Industrial sector share increased from 11% in 2000 to 28% in 2020
- Driven by Construction with 20% share in GDP in 2020
- **Manufacturing** increased from 5% in 2000 to 6.8% in 2020
- Deceiving structural transformation

Construction leads



Many Structural Constraints

- Input shortage caused by foreign exchange
- Frequent power interruptions
- High labour turnover
- Access to Finance esp. long-term and for SMEs

Financial Repression

- CBE - 58% of Assets, 60% of Deposits
- More than 80% going to SOEs
- Gov't and SOE loans chase cheap foreign exchange
- Lack of alternative sources of finance (long-term) - Capital Markets

DBE

- Intended for Green-Field sectors - costly for commercial banks
- Misaligned incentives - financed through 27% NBE Bill with cheap rates
- High NPLs given no collateral or strict regulatory system in place
- Adverse selection and Moral hazard

Private Banks

- Mostly Stable and prudent
- Loans are highly collateralized (about 97%)
- Short-term loans mainly for trade 56% - Manuf. 13.9% of loans
- Trade is easy for banks - short term and lucrative (inflation)
- Macro imbalances rearing ugly head here as well

Missing Middle

- Large firms are catered to by banks (with all its issues)
- Agri and micro firms are catered to by MFIs
- Small enterprises are missing
- They need larger loans - but banks require collateral
- Banks don't have specialized SME teams in place

Missing Middle (Cont'd)

- With the right incentives SMEs can graduate to become large firms
- Banks have perceived risk of lending to SMEs
- Banks also want to avoid the high unit cost of managing small loans

Improved Macro Balance

- Lower inflation - less monetary financing of deficit
- Prudent fiscal policy - pacing development projects (sustainability)
- Fair distribution of finance and forex
- Functioning financial market - sensitive to interest rates
- More competition in the banking sector

Capital Markets

- Access to long-term finance - through equity and debt instruments
- New proclamation passed in June 2021
- Firms need to be prepared - especially larger ones
- Allows for fairness in the market - if done right

Missing Middle

- Banks need SME business model (downscaling)
- Financial infrastructure development - address credit information gaps
- Government guarantee schemes - well thought out
- Movable collateral registry - underway
- MFIs need to upscale - some are becoming really large

Thank You