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1. Introduction

This quarterly macroeconomic report provides an update on the macroeconomic situation in Ethiopia, focusing on two key macroeconomic developments with significant implications for the Ethiopian economy. The exchange rate developments in the post-reform period cover July to mid-September 2024 while the international trade update delves into developments during the third quarter of the 2023/2024 Ethiopian fiscal year (January to March 2024). Some key macroeconomic issues affecting the country's economic stability are the accelerated depreciation of the ETB particularly after the exchange rate reform, the shortage of foreign exchange, and the widening spread of buying-selling rates.

Ethiopia's heavy reliance on primary exports tends to expose the country to the volatility of recurrent prices and foreign exchange earnings and the small size of exports contributes to the ongoing and widening trade deficit. Such persistent deficits and the associated financing requirements have forced the country to depend heavily on external debt, increasing its debt vulnerability and susceptibility to external shocks, ultimately forcing the country to resort to an IMF-backed macroeconomic reform program.

This report aims to provide policymakers, investors, and researchers with valuable insights into Ethiopia's latest macroeconomic landscape, focusing on the foreign exchange market and international trade developments. It aims to facilitate informed decision-making and effective policy interventions.

The following two sections of the updates discuss the key developments in the selected indicators.

2. Exchange Rate Dynamics in a Post-Reform Landscape

This section examines exchange rate dynamics in the post-reform period, spanning from July to mid-September 2024. It delves into the rapid depreciation of the currency (ETB) against the US Dollar, a key trend observed during this period. Additionally, the analysis explores the widening gap between buying and selling rates and the intensified competition among banks offering the most favorable exchange rates. Finally, the section investigates the response of the parallel market to the exchange rate reform, highlighting its short-term implications for the new macroeconomic policy environment.

Key facts and figures

- *The Ethiopian Birr (ETB) has rapidly depreciated against the USD in the post-reform period.*
- *Between July 30, 2024, and September 15, 2024, the exchange rate surged from ETB 57.8 to 117.3 per USD. This represents a nearly 103% depreciation, with a daily average of about 2.3%.*
- *As of September 16, 2024, the Development Bank of Ethiopia (DBE), Bunna International Bank, and Addis International Bank led the ranking with the highest buying rates, offering ETB 116.01, 115, and 112.44 per USD, respectively.*
- *As of September 16, 2024, Bunna International Bank topped the list with the highest selling rate at 124.91 ETB/USD. Close behind were Zamzam Bank and Tsedey Bank, offering rates of 124.44 ETB/USD and 123.15 ETB/USD, respectively.*
- *Since the reform period, the spread between buying and selling rates for USD has widened.*
- *The initial buying-selling exchange rate spread for USD was approximately ETB 1.63 in early August 2024. The spread surged to ETB 5.75(6%) by the first week's end and further climbed to a peak of ETB 10.4 (10%) by mid-August. While the spread increased slightly between mid-August and mid-September, it stabilized around ETB 11.6 (about 11%).*
- *Post-reform, the official-parallel exchange rate gap narrowed dramatically, falling from over ETB 65 (112.5%) per US dollar on July 29, 2024, on average, to around ETB 10 (10%) for most of the subsequent period up to Sep 16, 2024.*

2.1. Context of the Exchange Rate Reform

After decades of rapid growth and improvement of living standards, a series of shocks, including domestic conflict, the COVID-19 pandemic, droughts, and spillovers from the Russia-Ukraine war, coupled with macroeconomic policy shortcomings have pushed the country to a critical juncture. The public investment-led growth model has reached its limits, exacerbated by exchange rate overvaluation, insufficient policy adjustments, and imprudent economic management. These challenges have culminated in high inflation, falling exports, foreign exchange shortages, dwindling international reserves, and unsustainable external debt (International Monetary Fund (IMF), 2024). As of May 2024, Ethiopia's foreign exchange reserves were barely sufficient for one month of imports, and pressures on the fiscal and current account balances were mounting (UNDP, 2024). Additionally, the country's external debt has experienced a 1.9% year-over-year growth, reaching a staggering $28.8 billion by June 30, 2024. This rapid increase exacerbates the nation's debt problem (Ministry of Finance (MoF), 2024). The country faces significant debt servicing costs. According to MoF (2024), the cost of servicing external public sector debt exceeded $1.265 billion between July 2023 and June 2024, covering both principal and interest payments, as well as fees.

Ethiopia's overdependence on primary commodity exports, such as coffee and other agricultural products, has significant implications for its macroeconomic stability. This reliance exposes the country to fluctuations in global commodity prices, leading to volatile foreign exchange earnings and a persistent trade deficit. The small size of Ethiopia's export base exacerbates these challenges, contributing to the ongoing trade imbalance. To finance these deficits, the country has increasingly turned to external debt, raising concerns about debt sustainability and vulnerability to external shocks. The persistent trade deficits and growing debt burden have ultimately forced Ethiopia to seek support from the International Monetary Fund (IMF) through a macroeconomic reform program. This program aims to address the country's underlying economic challenges, including improving trade competitiveness, diversifying exports, and enhancing fiscal and monetary management.

Reflecting their ambition to transform the economic model towards private sector-led development, and recognizing the urgent need for reform, the Ethiopian government authorities developed the Home-Grown Economic Reform Agenda (HERA II). This ambitious plan aims to tackle the drivers of economic imbalances including moving to a market-determined exchange rate, modernizing the monetary policy framework, tackling challenges of fiscal revenues, and reforming state-owned enterprises (IMF, 2024). Ethiopia’s foreign exchange reform is just one part of a wider package of macroeconomic reforms to be implemented and accelerated over the coming months (NBE, 2024). On July 29, 2024, the government announced the introduction of a competitive, market-based exchange rate system, departing from the ‘managed floating’ exchange rate system, anticipating that this policy shift would yield substantial economic benefits for the nation.

The government highlights that the reform is domestically driven and not an IMF-induced program. However, critics argue that the country's severe macroeconomic challenges, which necessitate substantial foreign financing, have left the government with little alternative but to adopt the IMF's proposed exchange rate and broader macroeconomic reforms (ECOEMERGING[1], 2024). Accordingly, the Ethiopian authorities have requested a four-year arrangement under the Extended Credit Facility (ECF) for Special Drawing Right (SDR) 2,555.95 million (850 percent of the quota or about US$3.4 billion) to help address the protracted balance of payments needs related to structural external imbalances (IMF, 2024). Only $1 billion of the total $3.4 billion IMF disbursement will be provided to Ethiopia immediately, with the remaining $2.4 billion phased out over the next four years.

2.2. Pillars of Exchange Rate Reform

Since 1992, Ethiopia has adopted a 'managed floating' exchange rate system, characterized by occasional government interventions in the foreign exchange market to buy or sell currencies (UN, 2020). However, the IMF categorizes the previous exchange rate regime as a crawling-peg arrangement (IMF, 2024), i.e. not ‘managed float’. This shift from a ‘managed floating’ exchange rate system had profound economic implications, as evidenced by the immediate 30% depreciation of the Ethiopian Birr (ETB) against the US dollar. Over the subsequent days, the ETB continued its downward trajectory, culminating in a 75% depreciation. For instance, by August 5, 2024, the currency had lost three-quarters of its value against the USD.

The newly implemented market-based exchange rate regime represented a substantial departure from the prior managed floating system, incorporating several key changes. The key changes include

- **Market-determined exchange rate:** Ethiopia has shifted from a managed floating exchange rate regime to a fully flexible one, empowering market forces to dictate the value of ETB against foreign currencies. The NBE will no longer directly intervene to set the exchange rate. The Ethiopian birr is now allowed to fluctuate more freely in response to changes in market conditions, such as trade flows, capital movements, and investor sentiment.
- **Elimination of foreign exchange surrender requirements to the NBE:** The policy allows exporters and commercial banks to keep foreign exchange, significantly increasing foreign exchange supplies to the private sector.
- **Removal of import restrictions:** The import restrictions imposed on 38 product categories have been lifted, and the foreign exchange market has been liberalized for the imports of goods and services except for fuel-powered cars while capital account outflows remain restricted as before.
- **The improvement of retention rules:** Exporters are now permitted to retain 50% of their foreign exchange earnings, a significant increase from the previous 40% limit. This provision is designed to provide exporters with greater flexibility in managing their foreign exchange resources.
- **Removal of rules governing forex rationing:** The policy abolished the previous system of bank-imposed rules governing the allocation and rationing of foreign exchange, which often

[1] https://economic-research.bnpparibas.com/pdf/en-US/Emerging-February-13-2024-2/13/2024,49352

relied on waiting lists for various import categories. This reform was aimed to streamline the foreign exchange allocation process and promote greater efficiency in the foreign exchange market.

- **The introduction of non-bank foreign exchange bureaus:** Formal non-bank foreign exchange bureaus have been authorized to operate and are now permitted to buy and sell foreign currency cash notes at market rates following the acquisition of necessary licenses. This policy change aims to increase competition and improve efficiency in the foreign exchange market. By October 02, the NBE granted operational licenses to five non-bank foreign exchange bureaus. These bureaus are expected to play a significant role in further developing and deepening Ethiopia's foreign exchange market.
- **The removal of restrictions on Franco Valuta imports:** It has been mentioned that this was to be implemented shortly through an upcoming regulation. Accordingly, on August 19, 2024, the Ministry of Finance relaxed restrictions on Franco Valuta imports, allowing a wider variety of goods to enter Ethiopia without requiring the use of the domestic banking system for foreign currency transactions. This policy adjustment is a key component of the government's broader economic reforms designed to simplify import procedures and alleviate foreign currency shortages. While the ban on fuel-powered vehicles and security equipment remains in place, the new directive eliminates the need for Letters of Credit or other traditional payment methods for a wider range of imported goods. Previously, Franco Valuta was limited to essential items such as edible oil, rice, sugar, and baby formula.
- **The allowance for residents to open foreign currency accounts:** The reform allows residents to open foreign currency accounts based on remittance inflows, transfers from abroad, forex-based salary or rental income, and for other specified cases, as well as the ability to use such foreign currency accounts for foreign service payments.
- **Relaxation of foreign exchange controls:** Certain restrictions on foreign exchange transactions have been relaxed to promote greater convertibility and facilitate trade and investment.

Before the current reform, the NBE set the daily exchange rate according to a schedule targeting a particular devaluation at the end of the period. The NBE would often buy or sell foreign currency to stabilize the exchange rate or achieve specific policy objectives. This intervention limited the flexibility of the exchange rate to respond to market forces. However, the current reform limits NBE's intervention, and the rate is envisaged to be determined by the interaction of market forces (Tasew, Lamessa, and Arega, 2024).

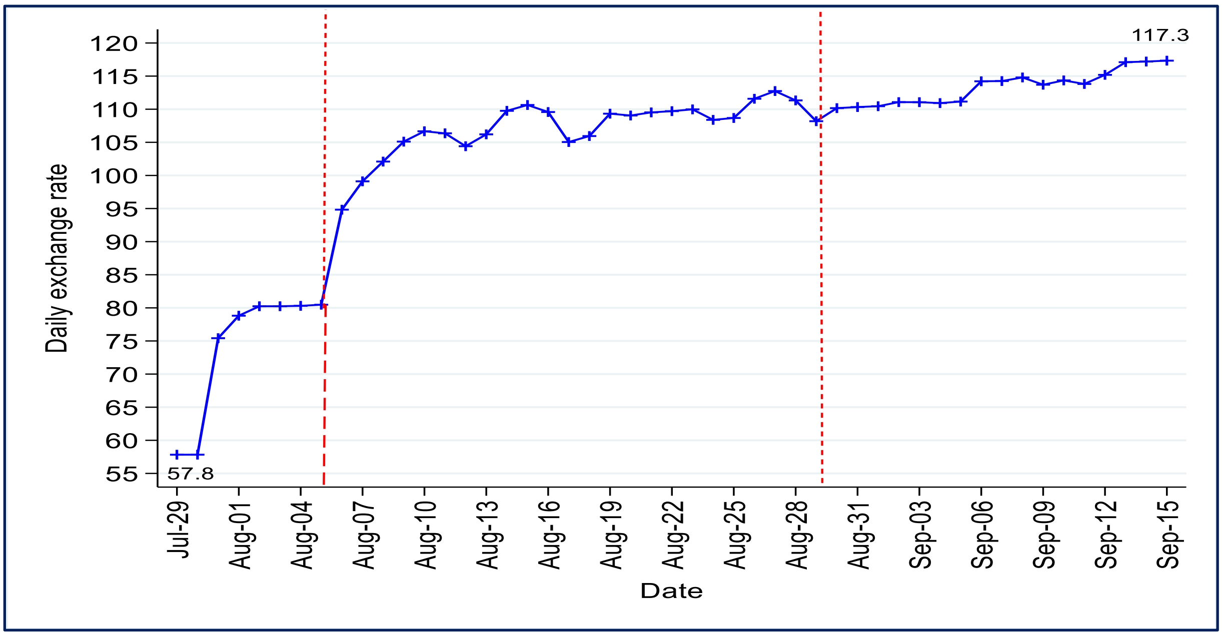
2.3. Exchange Rate Developments after the Reform: Accelerated Depreciation

The July 2024 exchange rate reform in Ethiopia marked a significant shift in the country's economic policy. The move, largely supported by the IMF, was aimed at addressing the longstanding gap between the official and parallel exchange rates, which had distorted the economy and hindered trade growth.

The ETB experienced a significant depreciation against major currencies like the US Dollar following the reform. It is rapidly weakening against the USD. The exchange rate has risen from

ETB 57.8 per dollar on July 30, 2024, to 117.3 on September 15, 2024. During the same period, analyzing the daily exchange rate movements, the ETB depreciated by nearly 102.8% between July 30, 2024, and September 15, 2024. This suggests that the ETB has depreciated by about 2.3 percent daily (Figure 1). This directly resulted from the shift to a market-based exchange rate system.

Figure 1: Trend of average daily exchange rates



Source: Computation based on data from Exchange Rates UK (2024) available at https://www.exchangerates.org.uk/USD-ETB-spot-exchange-rates-history-2024.html

Figure 1 shows the daily exchange rate of the ETB against the US Dollar (USD) from July 29, 2024, to September 15, 2024. The exchange rate was more volatile in the early days of the reform. It sharply increased until August 15, 2024, followed by a slight decrease, and then showed a further increment from August 30 onwards. The official exchange rate gradually increased throughout the period, reaching its highest point on September 15, 2024. The official rate experienced considerable depreciation after the reform where ETB has lost more than 100% of its value against the US dollar, requiring more ETB to buy one USD. The depreciation rate was exceedingly high.

Despite the accelerated depreciation, the exchange rate seems nearly stable in September. As the underlying causes of the stable exchange rate in September have not been thoroughly investigated, some speculate that reduced demand for foreign exchange by importers may be a contributing factor.

Despite significant dollar allocations by the Commercial Bank of Ethiopia (CBE), Ethiopian import and export traders are hesitant to utilize foreign currency from banks. For example, between July 22 and September 30, 2024, CBE disbursed over USD 282 million to various sectors, but businesses have only utilized 28% of these funds. This reluctance persists even though dollars are available at lower rates than those on the parallel market. According to the insight from

Addisinsight magazine[2], this low uptake underscores the gap between the availability of foreign exchange and the traders' capacity or willingness to access it.

The ongoing economic slowdown and inflation have dampened demand for imports, reducing the market's appeal for traders. Even with foreign exchange available at lower rates, many importers are concerned about weak consumer demand, which could lead to unsold inventory and unprofitable investments. In addition to the challenges posed by the economic slowdown, Ethiopia's tight monetary policy has further constrained access to forex for traders. The central bank's efforts to curb inflation and stabilize the economy through measures such as high interest rates have resulted in reduced liquidity in the domestic market. This liquidity crunch has made it difficult for businesses to secure the necessary local currency to settle foreign exchange payments, hindering their ability to import essential goods and services. Overall, many traders are either unable to secure the necessary Birr for pre-payments or are unwilling to assume the risks associated with the economic slowdown and volatile exchange rates.

The accelerated depreciation in the post-reform period appears to be the result of the rapid unification of the exchange rate suggested by the World Bank and the IMF amidst the critical shortage of forex in the country and the much-limited supply of forex compared to the rising demand. Considering this, the government wanted a more phased approach to correct the distortion. The important lesson from the experience of many countries, including Egypt and Nigeria, is to have abundant FX cushions to protect the currency during devaluation (UNDP, 2024).

Following the accelerated depreciation of the ETB and the increasing demand for foreign currency (US dollar) in the banking sector, the NBE made an auction on August 7, 2024. In an official statement, the NBE stated that the Special Auction saw the participation of 27 banks. The weighted average rate of all successful bids was Birr 107.9 per US Dollar (https://nbe.gov.et/fx-sale-auction/). NBE's Governor Mamo Mihretu made the following statement after the auction results were announced,

> *"We are pleased to see a substantial narrowing of the gap between bank exchange rates and parallel market rates over the past week, as well as meaningful progress towards exchange rate stability. This is precisely what our macroeconomic reforms intended to achieve—namely to ensure that most FX transaction activity can shift to the banking system, thereby helping both exporters bringing in foreign exchange as well as the many companies and entrepreneurs seeking foreign exchange."*

The Governor also welcomed the encouraging growth seen in the volume of FX transactions and noted:

> *"We are also pleased to see a growing number of banks making foreign exchange available to their customers by approving past import requests and accepting new*

[2] https://addisinsight.net/2024/10/why-ethiopian-import-and-export-traders-are-reluctant-to-take-dollars-from-banks-despite-cash-availability-at-lower-rates/

import requests; we anticipate and indeed expect more banks will follow this trend over the coming weeks and that they will do so with increasingly larger FX volumes."

Though the volume of transactions is not stated, the NBE's auctions are instrumental in addressing forex liquidity shortages within the banking system, narrowing the disparity between the official exchange rate and the parallel market rate, and promoting exchange rate stability. By strategically allocating foreign currency through these auctions, the NBE can effectively supply forex to the banking sector, manage the rising demand for foreign exchange, and stabilize the foreign exchange market.

NBE's intervention is in line with the agreement with the IMF. According to the IMF (2024), intervention in the foreign exchange market will be limited to stemming disorderly market conditions and malpractices. The NBE has approved an FX intervention strategy (including a governance process) that allows but does not oblige, the NBE to buy or sell foreign currency in volatile market conditions. Any FX intervention is agreed to be conducted via a public auction open to all banks. The Program highlights that NBE may conduct a limited number of low-value FX sale auctions during the two months immediately after the change of the FX regime to support price discovery, consistent with the framework. These policies support the objective of restoring foreign exchange reserves to adequate levels to reduce external vulnerabilities, by the end of the program.

In addition, as a transitional measure to facilitate clearance of pre-existing obligations for fuel imports until the Ethiopia Petroleum Supply Enterprise has had time to build up adequate FX by regular purchases at the market rate, NBE may use a maximum of US$670 million to settle LCs for fuel imports that fall due in July and August 2024. Such payments, to be made at the prevailing market exchange rate, would not be subject to the FX intervention framework (IMF, 2024).

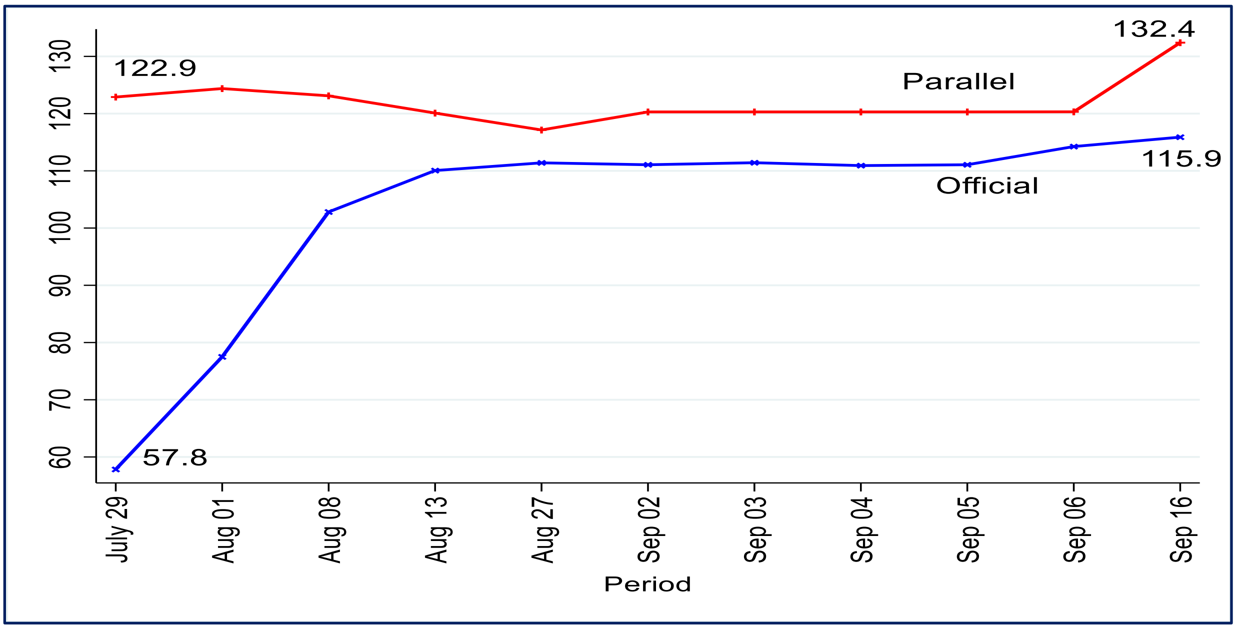
2.4. Exchange Rate Gap in the Official and Parallel Markets

Over the past years, the exchange rate has been significantly misaligned. The significant gap in the exchange rate has been one of the biggest distortions harming the nation's economy. This misalignment was indicated by the large gap between the official and black-market exchange rates. For instance, as of September 30, 2023, the official market rate was ETB 55.2 per dollar, while the parallel market traded on average, at over ETB 112 per dollar, resulting in a gap of about 103% (EEA, 2024a).

Ethiopia's foreign exchange reform introduced in late July 2024 marked a significant shift in its economic policy. By liberalizing its currency market, the government aimed to align the official exchange rate with market forces, reducing the gap between the official rate and the black-market rate. The ETB depreciated significantly, bringing the official rate closer to the black-market rate, and significantly reducing the exchange rate misalignment.

Following the reform, the exchange rate gap decreased from over ETB 65 per US dollar (112.5%) on July 29, 2024, to just ETB 6 per dollar (5.3%) on September 06, 2024, and stabilized around ETB 10 (9.6%) for most of the post-reform period (Figure 2). The narrowing gap may encourage using official market channels for currency exchange in the country. This is in line with the goal of the reform. One of the key aspects of the macroeconomic reform program was the implementation of a market-based exchange rate, unifying official and parallel foreign exchange (FX) markets, to help address external imbalances and relieve FX shortages (IMF, 2024).

Figure 2: Official and Parallel Exchange Rates (ETB/USD), some selected days during July-September 2024



Source: Computation based on Exchange Rates UK (2024) available at https://www.exchangerates.org.uk/USD-ETB-spot-exchange-rates-history-2023.html and https://ethioblackmarket.com

Though the difference between the official and parallel rates tends to decline gradually, the parallel exchange rate fluctuated throughout the period. It started at a relatively high level on July 29, then experienced a slight decline before rebounding to a new high on September 16, 2024. There have been periods of divergence, suggesting considerable disparities between the official and parallel markets due to strong demand for foreign currency on the black market. For instance, as of September 16, 2024, the parallel rate was significantly higher than the official rate. The parallel market exchange rate surged to ETB 132.4 per dollar. This sharp increase follows some banks implementing a 16% bonus on their remittance buying rates, which initially seemed to attract more foreign currency through the banking channel. However, instead of narrowing the gap, the parallel rate increased significantly. With demand increasing and forex supply not keeping pace despite bank incentives, people may be turning more to the black market to obtain foreign currency. The difference between the official and parallel exchange rates decreased significantly during the period but then increased again on September 16, 2024. This shows that the gap between the exchange rate set by the banks and the rate at which ETB is traded in the parallel market is gradually narrowing after the reform. This suggests some success in aligning the official rate with market realities.

Apart from the limited availability of foreign exchange in the formal market, other factors may influence the preference for the parallel market. The process of obtaining foreign currency through official channels can be time-consuming, involving multiple bureaucratic steps and paperwork.

Banks may take significant time to process applications and disburse funds, leading to delays in import operations. Moreover, the rigorous documentation requirement from banks can be a burdensome and time-consuming process.

2.5. Variation in the Buying and Selling Rates across Banks

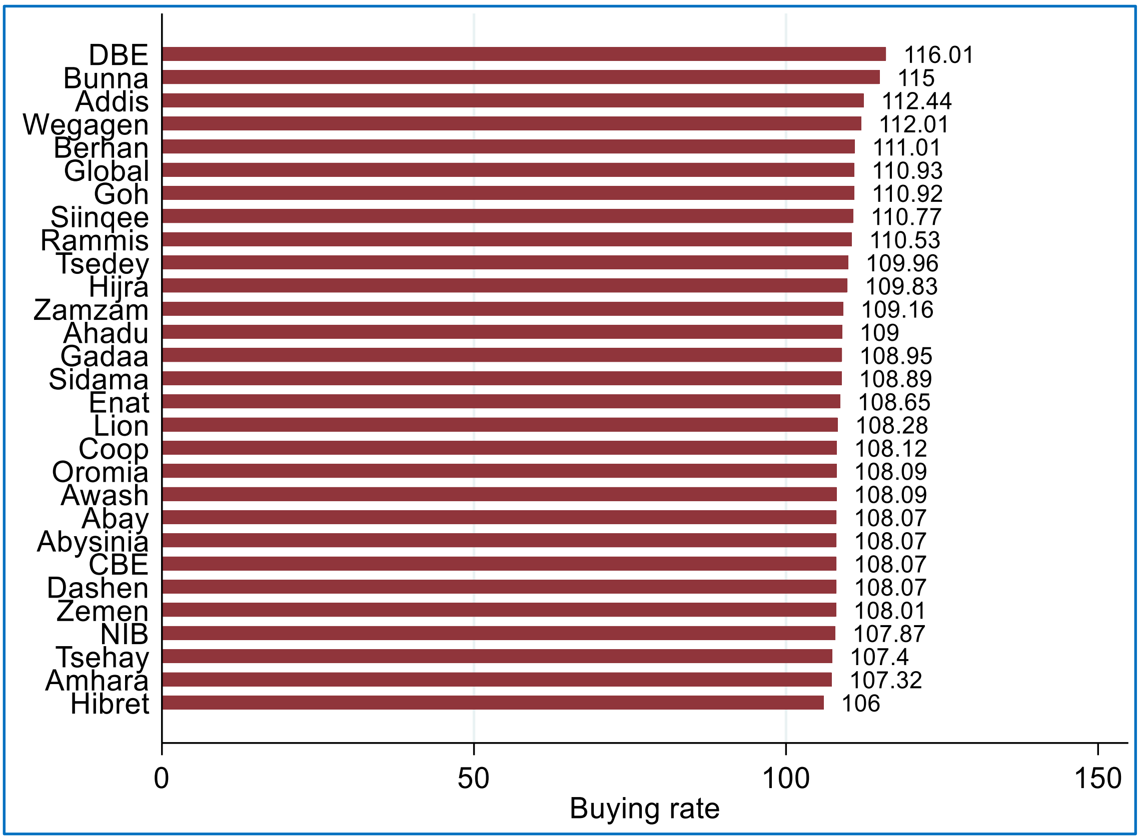
The exchange rate reform in Ethiopia has significantly altered the competitive landscape for foreign currency buying and selling among Ethiopian banks. Introducing a market-based exchange rate system has opened opportunities for banks to compete more aggressively in pricing and services. Moving away from a ‘managed’ floating exchange rate regime has allowed banks to set their own buying and selling rates based on market conditions. Given the shortage of foreign currency, this has intensified competition among banks to attract customers with attractive rates. With more flexibility in pricing, banks have been incentivized to compete more aggressively for foreign exchange business. This has led to a gradual increment in spreads between buying and selling rates.

Figure 3 shows the ranking of Ethiopian commercial banks based on their buying rates for the Ethiopian Birr (ETB) against the US Dollar (USD) on September 16, 2024. The DBE, Bunna International Bank, and Addis International Bank lead the ranking sector with the highest buying rates at ETB116.01, 115, and 112.44 per USD, respectively. A cluster of banks occupy the middle of the ranking with buying rates ranging from ETB 112.01 per USD to ETB 109 per USD. This group includes banks such as Wegagen Bank, Berhan International Bank, Global Bank, Goh Bank, and Siinqee Bank. At the lower end of the ranking are banks such as Hibret Bank, Amhara Bank, Tsehay Bank, Oromia International Bank, and NIB, with buying rates ranging from ETB 106 per USD to 108.9 per USD.

Notwithstanding the competition among Ethiopian banks in terms of offering a favorable buying rate for their customers, there is a significant variation in selling rates across Ethiopian banks, ranging from a low of ETB 106 for Hibret Bank to a high of 116 for DBE, indicating a modest gap of ETB 10. It highlights the variations in buying rates offered by different banks.

The foreign exchange market in Ethiopia has been marked by significant volatility, with exchange rates fluctuating frequently. A key driver of this volatility has been the disparity in buying and selling rates among different banks. To attract customers and optimize their foreign currency holdings, banks have adjusted their rates competitively.

Figure 3: Ranking of banks by their buying rates, September 16, 2024

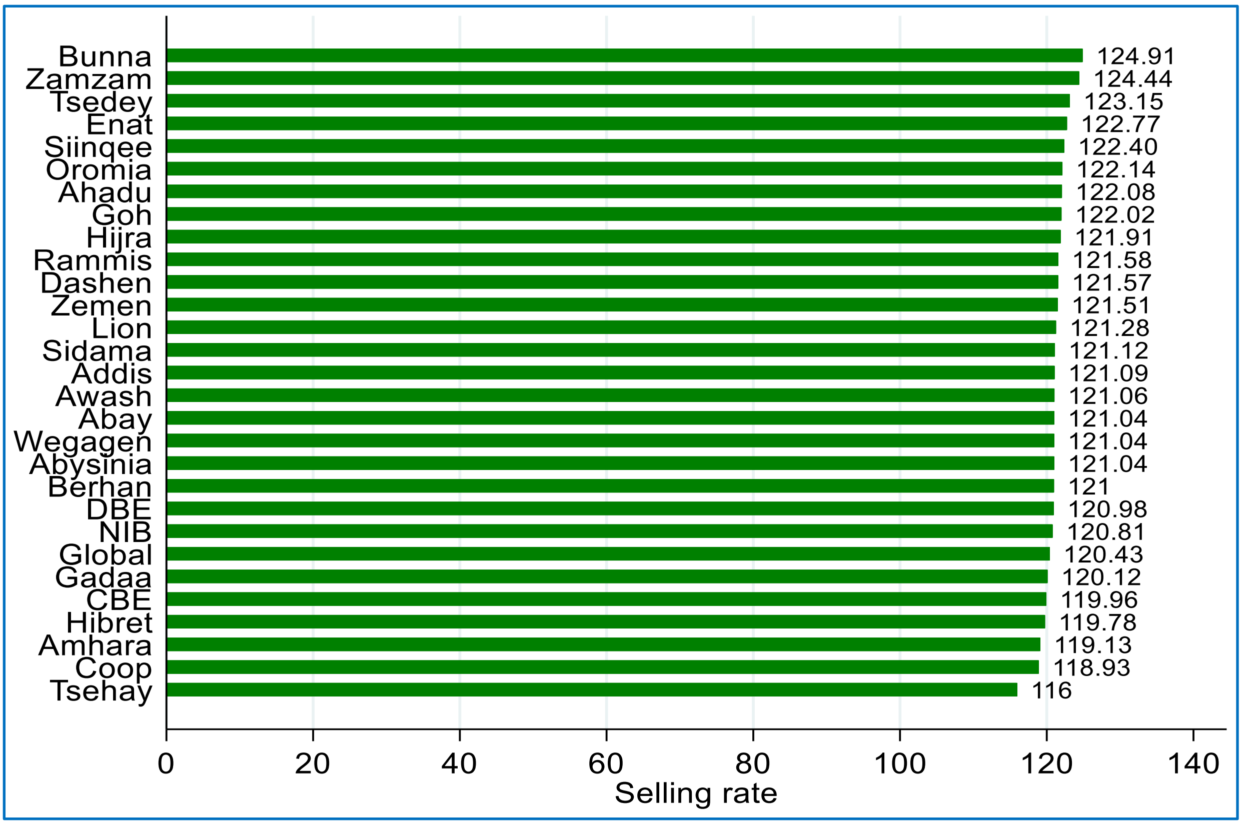


Source: Computation based on data from Ethioxchange (2024), available at http://www.ethioxchange.com/currency/usd (2024)

While other factors such as economic uncertainty and domestic economic policies may influence exchange rates, the primary driver has been the intense competition among banks to acquire foreign currency deposits. In the evolving market landscape, banks have sought to differentiate themselves by offering attractive exchange rates to customers.

Figure 4 shows the ranking of commercial banks in Ethiopia based on their selling rates for the US Dollar (USD) against ETB on September 16, 2024. Some key observations from the graph show that Bunna International Bank leads the ranking with the highest selling rate at 124.91 ETB/USD. Zamzam Bank and Tsedey Bank follow closely with selling rates of 124.44 ETB/USD and 123.15 ETB/USD, respectively. A cluster of banks occupies the middle of the ranking with selling rates ranging from 122.77 ETB/USD to 121.09 ETB/USD. This group includes prominent banks like Oromia International Bank, Awash Bank, Addis International Bank, Wegagen Bank, and Berhan International Bank. At the lower end of the ranking are banks such as Nib International Bank, Global Bank, Gadaa Bank, Commercial Bank of Ethiopia (CBE), Hibret Bank, and Tsedey, with selling rates ranging from 120.81 ETB/USD to 116 ETB/USD.

Figure 4: Ranking of banks by their selling rates, September 16, 2024



Source: Computation based on data from Ethioxchange (2024), available at http://www.ethioxchange.com/currency/usd

Figure 4 reveals tight competition among Ethiopian banks in terms of exchange rates. There is a significant variation in selling rates across Ethiopian banks, ranging from a low of ETB 116 to a high of about 125, indicating a gap of ETB 9. The graph provides valuable insights into the exchange rate landscape in Ethiopia and the competitive dynamics among commercial banks. It highlights the variations in selling rates offered by different banks and allows businesses and individuals to make informed decisions when exchanging currency.

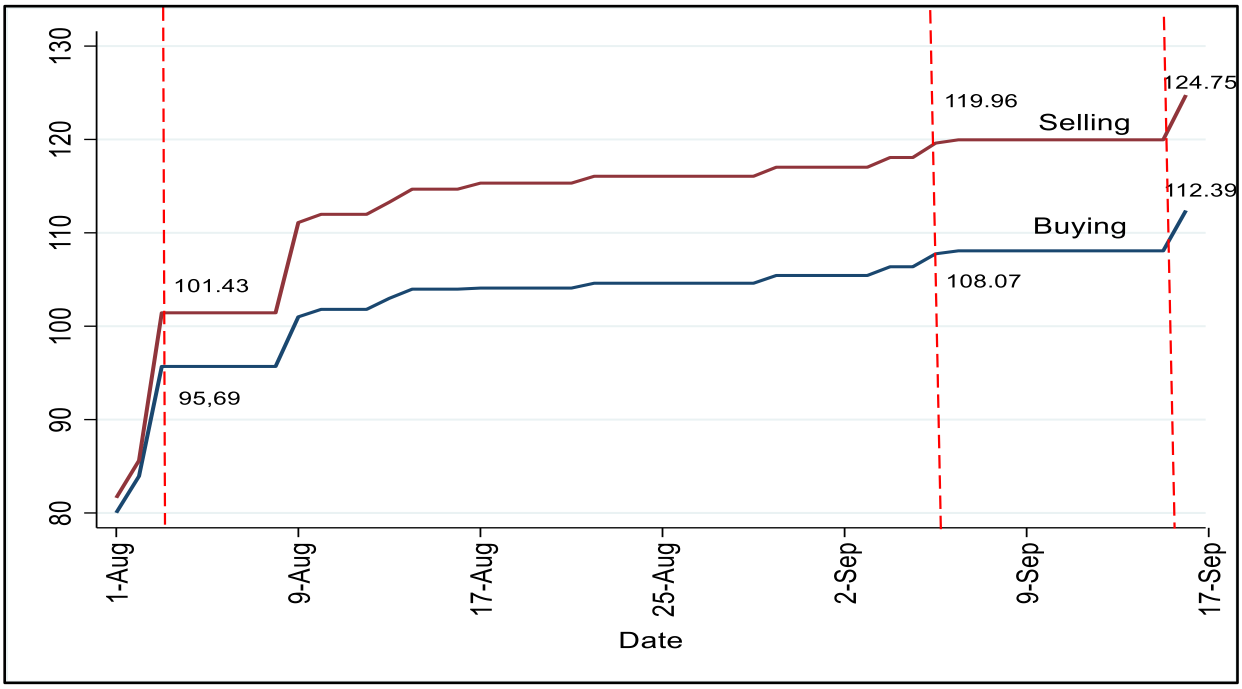
Both buying and selling rates indicate that there are variations in the buying and selling exchange rates among different banks. Overall, as of September 16, 2024**,** the bank with the lowest buy rate was Hibret Bank, with a rate of ETB 106 while the bank with the highest buy rate was Bunna Bank, with a rate of ETB 116. The bank with the lowest sell rate was Tsehay Bank, with a rate of ETB 116 while the bank with the highest sell rate was Bunna, with a rate of ETB 124.91. These variations may be influenced by factors such as the bank's size, reputation, and foreign currency reserves.

2.6. Foreign Exchange Trading Spread

Following the implementation of the new regulations, there is evidence that banks are widening the gap between their buying and selling rates, often called ‘bid-ask spread’. Foreign exchange spread refers to the difference between the price at which a currency dealer such as a bank is willing to buy a currency (also known as bid price) and the price at which they are willing to sell it (ask price). Essentially, it's the transaction cost of buying or selling a currency.

Figure 5 presents the differential between the average buying and selling rates of foreign exchange at Ethiopian banks. It shows that there appears to be a general upward trend in both the buying and selling rates of the US dollar throughout the period. This suggests that the ETB was depreciating against the US dollar. The overall trend of the exchange rate spread is upward, indicating that the difference between the buying and selling rates for the US dollar has been increasing over time. The most significant increase in the selling and buying spread occurred between August 9th and August 16th. The spread jumped from around ETB 5 to ETB 10 during this period. After the peak in mid-August, the spread remained relatively stable, hovering around ETB 11-12. While there is an overall upward trend, there are periods of minor fluctuations at both rates.

Figure 5: Trend of average daily exchange rate spread of banks in Ethiopian, August 01-September 16, 2024



Source: Computation based on data from Ethioxchange (2024), available at http://www.ethioxchange.com/currency/usd (2024)

Figure 5 demonstrates that the initial buying-selling exchange rate spread to the US dollar following the exchange rate reform averaged approximately ETB 1.63 in the first few days of August 2024. However, this spread experienced a significant increase, reaching ETB 5.75 by the end of the first week of the month. This upward trend continued to accelerate, culminating in a peak of ETB 10.4 between the 9th and 16th of August 2024. While the spread experienced a slight increase from the 17th of August to the 16th of September, it remained relatively stable at around ETB 11.6 during this period.

The average spread between the buying and selling rates has widened over the period under review. This generally indicates a higher profit margin for the banks involved in foreign exchange transactions. While there have been minor fluctuations, the overall difference between the buying and selling rates has remained relatively consistent, suggesting that banks have maintained a consistent profit margin. The difference between the bid and ask price represents the dealer's profit on each transaction. Thus, a wider spread means that banks are making a higher potential profit per trade.

The high and widening exchange rate spread in Ethiopia's foreign currency market, particularly after the reform, can be attributed to the chronic shortage of foreign exchange and the few sources of foreign currency. Such limited supply in the presence of unmet demand drives up prices. The shortage of foreign exchange is primarily due to the high import demand and the limited export earnings generated in the economy. For instance, exports from October 2023 to December 2023 totaled only $770 million, exhibiting a 7.5% decline from $833.1 million in the previous quarter. During the same period, total merchandise import bills amounted to $4.8 billion on 31 December 2023. As a result, in the last quarter of 2023, the country had a merchandise trade deficit of about $4.3 billion (EEA, 2024b). A related issue is the relatively new or underdeveloped foreign exchange market with limited liquidity and tougher competition to secure the few available forex, leading to wider spreads. The competition among banks to attract foreign currency is leading to aggressive efforts to meet customers' needs and generate profits. This competition can drive up the prices that banks offer to buy foreign currency, resulting in wider spreads between the buying and selling rates. Ethiopia's transition to a market-based exchange rate system offers greater flexibility and efficiency but may also result in increased volatility and wider spreads. What is more, uncertainty about the future direction of the economy coupled with macroeconomic instability or uncertainty can lead to increased volatility and wider spreads.

The agreement with the IMF allows for interventions to stabilize the market. The NBE adopted a foreign exchange intervention (FXI) strategy. Under the FXI strategy, the NBE can but is not obliged to intervene to stem disorderly movements in the exchange rate (IMF, 2024). Accordingly, the NBE may have room to intervene to narrow excessive exchange rate spreads.

In Uganda, Central Bank regulations limit the bid-ask spread to 10 shillings; anything beyond that is penalized. In Malawi, maximum spreads between buying and selling exchange rates are set at 2% for Telegraphic Transfer (TT) and 3% for cash. In Zambia, the difference between the buying price (bid price) and the selling price (ask price) of a currency should not exceed 0.05 Zambian Kwacha. On the other hand, in Kenya and Sierra Leone, authorized dealers freely determine their bid-ask spreads and foreign exchange commissions in transactions with their clients (European Investment Bank, 2022). By learning from the experiences of other developing/African countries, the NBE can implement appropriate regulations to ensure fair pricing and foster a more competitive and efficient foreign exchange market.

3. International Trade Developments

This section offers a comprehensive overview of Ethiopia's international trade performance during the third quarter of the 2023/2024 Ethiopian fiscal year (January to March 2024). It examines the composition of Ethiopia's exports, including agricultural products and manufactured goods as well as the countries to which these exports are primarily shipped. Additionally, the analysis delves into the types of goods Ethiopia imports, their origins, and the country's trade balance. By exploring these key aspects, this analysis provides a nuanced understanding of Ethiopia's external trade dynamics during the review quarter.

Key facts and figures

- *During the review quarter, Ethiopia exported goods worth only $784.3 million, demonstrating a modest growth of 1.7% nominal value from the previous quarter.*
- *Coffee held the top position, contributing 31.5% of the total merchandise export revenue, followed by oil seeds (21.13%) and cut flowers (16.2%).*
- *The Netherlands is the top destination for Ethiopian exports, accounting for 11% of the total value, followed by UAE (9.6%) and Saudi Arabia (9.13%).*
- *Saudi Arabia was the top destination for Ethiopian coffee exports, accounting for nearly 19% of the total. Belgium (9.4%) and the United States (9.13%) followed closely.*
- *The UAE is the top destination for Ethiopian oil seed exports, accounting for 27.85% of the total. Israel and Türkiye follow, with shares of 17% and 11.6%, respectively.*
- *Total merchandise import bills amounted to $6.18 billion (nominal value) in the review quarter, representing a substantial increase of 29.2% compared to the previous quarter.*
- *Mineral or chemical fertilizers, palm oils, and airplane parts and helicopters are the top import categories, accounting for 4.7%, 3.1%, and 2.7% of the total, respectively.*
- *China dominates Ethiopia's import market, supplying 38.5% of the goods. India and Morocco follow, with 11.1% and 6.2% shares, respectively.*
- *The country had a merchandise trade deficit of $5.39 during the review quarter, compared to $4.3 billion in the previous quarter.*

3.1. Export Performance

During the review quarter from January to March 2024, Ethiopia exported goods totaled only \$784.3 million. Exports experienced a slight increase in nominal terms, indicating a limited growth of 1.7% from the previous quarter (\$770.7 million). The size of the country’s exports is tiny relative to the country’s economic size and that of import demand. According to the IMF, Ethiopia's merchandise exports totaled \$4.27 billion in 2023, with earnings declining by about 15% compared to 2022. In 2004, exports of goods and services accounted for 6.7% of GDP in 2023. This is considerably far below the SSA average (24.9%) and countries in Eastern Africa such as Kenya (34%), Uganda (36%), Somalia (96%), and Djibouti (340%) (EEA, 2024c).

The country has faced several challenges in boosting its export performance. One of the major factors is its dependency on the export of primary commodities. Ethiopia's exports are heavily reliant on primary commodities like coffee, oilseeds and pulses, and livestock and livestock products. The country’s heavy reliance on agriculture and primary commodities has remained unchanged over the past several decades. This makes the country vulnerable to global price and demand shocks. Exporting raw materials generally yields lower revenues compared to processed or manufactured goods. On the other hand, exporting processed agricultural products rather than raw commodities benefits society much more than just the increased value of the commodities themselves. Processing adds to the value of the products and generates greater business activity, more jobs, higher personal income, and greater tax revenues (Gerald and William,1989). More importantly, manufactured products are relatively more competitive in the international market, leading to more stable prices and export earnings.

Apart from the export structure, political instability and lingering conflicts in Ethiopia disrupt trade routes and create security risks for businesses, deterring the production and supply of exportable items.

3.1.1. Major Exports

Table 1 reveals that coffee is the country's leading export, contributing 31.5% of the total merchandise export revenue. This highlights Ethiopia's heavy dependence on coffee for foreign exchange and demonstrates the commodity’s crucial role in the economy. Following coffee, oilseeds account for 21.13% of exports while cut flowers represent 16.2%. Notably, cut flowers rank as Ethiopia's third-largest export product, and the floriculture sector serves as a major source of employment, particularly for women. Pulses, Chats, textiles and garments are also significant contributors to export revenue generation. In summary, the data on Ethiopia's top ten export products provides a valuable snapshot of the country's export. The data suggests that Ethiopia has a strong presence in the global market for coffee, oilseeds, and flowers.

In terms of the commodity composition, Ethiopia’s exports are heavily reliant on agriculture, with the top five agricultural products—coffee, oilseeds, flowers, pulses, and chat—accounting for 85.4% of total merchandise exports. This may suggest the significance of agriculture in Ethiopia’s economy. However, the prevalence of agricultural goods in the export basket tends to expose the country to volatility of prices and earnings.

Table 1: Top 10: Export products (January-March 2024)

Rank	Commodity	Value (million USD)	Share (%)
1	Coffee	245.6	31.5
2	Oil Seeds	164.9	21.1
3	Flower	126.2	16.2
4	Pulse	79.4	10.2
5	Chat	49.3	6.4
6	Textile and garment	31.3	4.0
7	Meat and meat products	19.9	2.5
8	Chat	16.2	2.1
9	Vegetables	15.7	2.0
10	Live animals & feed	11.4	1.5

Source: Computed based on data in MoTRI (2024)

Coffee remains the cornerstone of Ethiopia's export sector and continues to play a crucial role in the economy. The country's reputation for producing high-quality coffee contributes to its competitiveness in the global market. Maintaining and enhancing coffee production quality and sustainability is crucial for the country's export growth.

While coffee is the dominant commodity, the presence of other significant agricultural goods in the export basket indicates some degree of export diversification, at least within the agricultural sector. Diversifying exports can reduce reliance on a single product and help mitigate risks. Expanding exports of other agricultural products, such as oil seeds, flowers, and pulses, and manufacturing goods can contribute to export growth. Additionally, the presence of goods such as textiles and garments reveals potential for growth in the manufacturing sector. Although Ethiopia has been suspended from the AGOA, nearly half of textiles and garments exports (48.2%) are still destined for the USA market. This can help mitigate risks associated with relying heavily on a single commodity.

3.1.2. Destinations of Exports

In 2023, Ethiopia exported to about 153 destinations worldwide (EEA, 2024b). Table 2 outlines Ethiopia's top 10 export destinations during the review quarter, based on their value in million USD. The Netherlands is the top destination for Ethiopian exports, accounting for 11% of the total value. This suggests strong trade ties and a developed market for Ethiopian products. Middle Eastern markets, the UAE, and Saudi Arabia are important markets for Ethiopian exports, each representing around 9% of the total value. This indicates a growing demand for Ethiopian products in the Middle East. Somalia and Djibouti, both neighboring countries, are among the top 10 export destinations, highlighting the potential for increased regional trade. The top 10 destinations include countries from Europe, Asia, Africa, and North America, demonstrating the diversity of Ethiopia's export markets.

Table 2: Top 10 destinations for Ethiopia's exports (January-March 2024)

Rank	Country	Value (million USD)	Share (%)
1	Netherlands	85.9	11
2	United Arab Emirates	75.4	9.6
3	Saudi Arabia	71.2	9.1
4	United States	52.9	6.8
5	Israel	36.8	4.7
6	Somalia	33.2	4.2
7	Djibouti	28.6	3.6
8	India	27.2	3.5
9	Belgium	26.1	3.3
10	Sudan	25.9	3.3

Source: Computed based on data in MoTRI (2024)

Table 2 suggests regional trade importance. Ethiopia's trade is heavily concentrated in the Middle East and Africa, highlighting the importance of proximity. The Netherlands and the United Arab Emirates have established strong trade relationships with Ethiopia, making them key markets for Ethiopian exports. While the Middle East and Africa are dominant at 34.5% of the top ten export destinations, the presence of other destinations like the United States and India indicates a degree of export diversification in commodity destinations, reducing reliance on any single region. The presence of countries like Somalia and Djibouti suggests opportunities for increased trade within the East African region and regional integration.

3.1.3. Major Exports by Destination

Table 3 outlines Ethiopia's top 10 coffee export destinations during the first quarter of 2024, based on their value in million USD. During the review quarter, coffee was exported to about 53 destinations. Saudi Arabia emerged as the primary destination for Ethiopia's coffee exports, accounting for nearly 19% of total coffee exports. Most of Ethiopia's top coffee export destinations are in the Middle East and Asia, indicating Ethiopia's strong market presence in these regions. While Saudi Arabia is the leading destination, the presence of other countries like Belgium, the United States, and Germany demonstrates a diversified export destination. It suggests a strong global demand for Ethiopian coffee.

Table 3: Top five destinations for coffee (January-March 2024)

Rank	Destinations	Value (million USD)	Share (%)
1	Saudi Arabia	47.0	19.1
2	Belgium	23.1	9.4
3	United States	22.9	9.3
4	Korea, Republic of	19.2	7.8
5	Germany	17.8	7.3

Source: Computed based on data in MoTRI (2024)

Table 4 shows the top five destinations for Ethiopia's oil seed exports in the first quarter of 2024. The data is presented in terms of the value of exports in million USD and the share of each destination in the total exports of oil seeds.

Table 4: Top five destinations for Oil seeds (January-March 2024)

Rank	Destination	Value (million USD)	Share (%)
1	United Arab Emirates	45.9	27.9
2	Israel	28.1	17.0
3	Türkiye	19.2	11.6
4	Singapore	18.9	11.5
5	Viet Nam	11.4	6.9

Source: Computed based on data in MoTRI (2024)

Table 4 shows that the United Arab Emirates is the top destination for Ethiopia's oil seeds exports, accounting for 27.95% of the total exports. Israel is the second largest destination, with a share of 17%. Turky, Singapore, and Vietnam follow in the third, fourth, and fifth positions. These five destinations together account for about 75% of Ethiopia's oil seeds exports in the quarter. This suggests that Ethiopia's oil seeds exports are concentrated in a relatively small number of markets. It is also worth noting that the value of exports to each destination varies significantly, with the United Arab Emirates receiving almost three times as much as Vietnam.

Table 5 shows the top five destinations for Ethiopia's cut flower exports in terms of the value of exports in million USD and the share of each destination in the total exports of the commodity. Ethiopia holds 2% of the global market share in flower exports, making it the sixth-largest flower exporter in the world, following Belgium. The country is currently the second largest flower exporter in Africa after Kenya[3].

[3] https://www.worldatlas.com/articles/global-leaders-in-cut-flower-exports.html

Table 5: Top five destinations for cut flowers (January-March 2024)

Rank	Destination	Value (million USD)	Share (%)
1	Netherlands	80.5	63.8
2	Saudi Arabia	12.6	10.00
3	United Kingdom	7.0	5.5
4	United Arab Emirates	3.9	3.1
5	United States	3.8	3.1

Source: Computed based on data in MoTRI (2024)

The Netherlands is the primary destination for Ethiopia's cut flower exports, accounting for nearly 64% of the total value. This suggests a strong market presence and established trade relationships. The next two largest markets are Saudi Arabia and the United Kingdom, each representing around 10% and 5% of the total flower exports, respectively. The United Arab Emirates and the United States, while smaller than the top three, still hold significant shares of 3.12% and 3%, respectively.

Cut flower exports tend to have a European market focus. The Netherlands, being a major hub for the global flower trade, plays a pivotal role in Ethiopia's exports. This suggests that Ethiopia may need to diversify its export markets to reduce reliance on the European market. The data also shows that Saudi Arabia's position as the second-largest destination highlights the growing demand for cut flowers in the Middle East. This region presents opportunities for further expansion. Moreover, the presence of the United Kingdom, United Arab Emirates, and the United States in the top five indicates that Ethiopian cut flowers have the potential to reach various global markets. However, increased marketing efforts and trade promotion may be necessary to tap into these markets more effectively. Overall, the data suggests that Ethiopia has a strong foundation in the global cut flower market, but strategic expansion and diversification are essential to sustain its growth and competitiveness.

Table 6 displays the top five destinations for Ethiopia's pulse exports in the first quarter of 2024. It includes the value of exports in million USD and the share of each destination in the total exports of the commodity. India is the primary destination for Ethiopia's pulse exports, accounting for over 25% of the total value. Pakistan follows India as the second largest destination. This suggests a strong market presence and established trade relationships with these two Asian countries. Sudan and Kenya, both neighboring countries, are significant markets for Ethiopian pulses, each representing around 9.2% and 7% of the total exports, respectively.

Ethiopia's pulse exports are heavily concentrated in Asian markets, particularly India, Pakistan, and Turkey, suggesting that diversifying export destinations can reduce potential risks and enhance market stability. The data also demonstrates there are regional trade opportunities in Africa. The strong presence of Sudan and Kenya as major destinations highlights the potential for increased trade within the African continent. Ethiopia could explore opportunities to expand its exports to other African countries with a growing demand for pulses. Since the product is exported without any value addition, exploring opportunities to export value-added pulse products, such as processed or packaged goods, can increase export earnings and create more jobs.

Table 6: Top five destinations for pulse (January-March 2024)

Rank	Destination	Value (million USD)	Share (%)
1	India	20.5	25.9
2	Pakistan	9.7	12.2
3	Sudan	7.3	9.18
4	Kenya	5.3	6.7
5	Türkiye	3.3	4.1

Source: Computed based on data in MoTRI (2024)

Table 7 displays the top five destinations for Ethiopia's Chat exports in the first quarter of 2024. It includes the value of exports in million USD and the share of each destination in the total exports of the commodity. Somalia and Djibouti, both neighboring countries, account for the overwhelming majority of Ethiopia's chat exports, combined representing over 85% of the total value. The remaining three destinations (Israel, Sierra Leone, and Kenya) have relatively small shares, suggesting that Chat exports are concentrated in a few specific markets.

Table 7: Top five destinations for Chat (January-March 2024)

Rank	Destination	Value (million USD)	Share (%)
1	Somalia	22.0	44.1
2	Djibouti	20.7	41.5
3	Israel	6.3	12.7
4	Sierra Leone	0.7	1.3
5	Kenya	0.2	0.4

Source: Computed based on data in MoTRI (2024)

Chat exports data reveal that there is strong regional trade dependence. Ethiopia's Chat exports are heavily reliant on neighboring countries, particularly Somalia and Djibouti. This dependence can make the industry vulnerable to political instability or changes in trade policies in these regions. The limited geographical spread of Chat exports indicates that the product is consumed in a limited number of countries and is illegal in many countries. This poses significant challenges to the commodity’s international trade.

3.2. Import Performance

According to UNCTAD’s data, Ethiopia’s imports reached $17.8 billion in 2023. According to IMF’s African Economic Outlook (2024) data, Ethiopia’s imports of goods and services as a percentage of GDP have been higher than the SSA average until 2016 when imports averaged 31.8% while SSA's was 28%. However, the country's imports declined in the post-2016 period, declining from 27.9% in 2016 to 14.3% in 2023. Moreover, between 2004 and 2023, imports as a percentage of GDP dropped by 53.7 percentage points from 31% in 2004 to 14.4% in 2023. However, the share of imports of goods and services in the SSA increased from 24.8% in 2004 to 28.4% in 2023.

The decline in the value of imports and its share of GDP since 2016 might be possibly linked to rising global commodity prices, disruptions in global supply chains, such as those caused by COVID-19, limited availability and depletion of foreign exchange reserves, conflict and the slowdown in economic activity.

3.2.1. Major Imports

According to the Ethiopian Statistical Service (ESS) (2024), the value of merchandise imports into Ethiopia during the third quarter (July-September 2024) reached a significant high of $6.2 billion[4]. This represents a substantial increase of 29.2% compared to the previous quarter (October-December 2023). Notably, this translates to a growth of $4.2 billion in import value within a single quarter.

Despite the severe shortage of foreign exchange affecting traders in the official market and the depletion of the country's foreign currency reserves, the value of imports increased significantly. Apart from demonstrating the growing demand for imports, this surge may be attributed to the fact that, in addition to the foreign currency available through official channels, importers were also accessing foreign exchange from the black market.

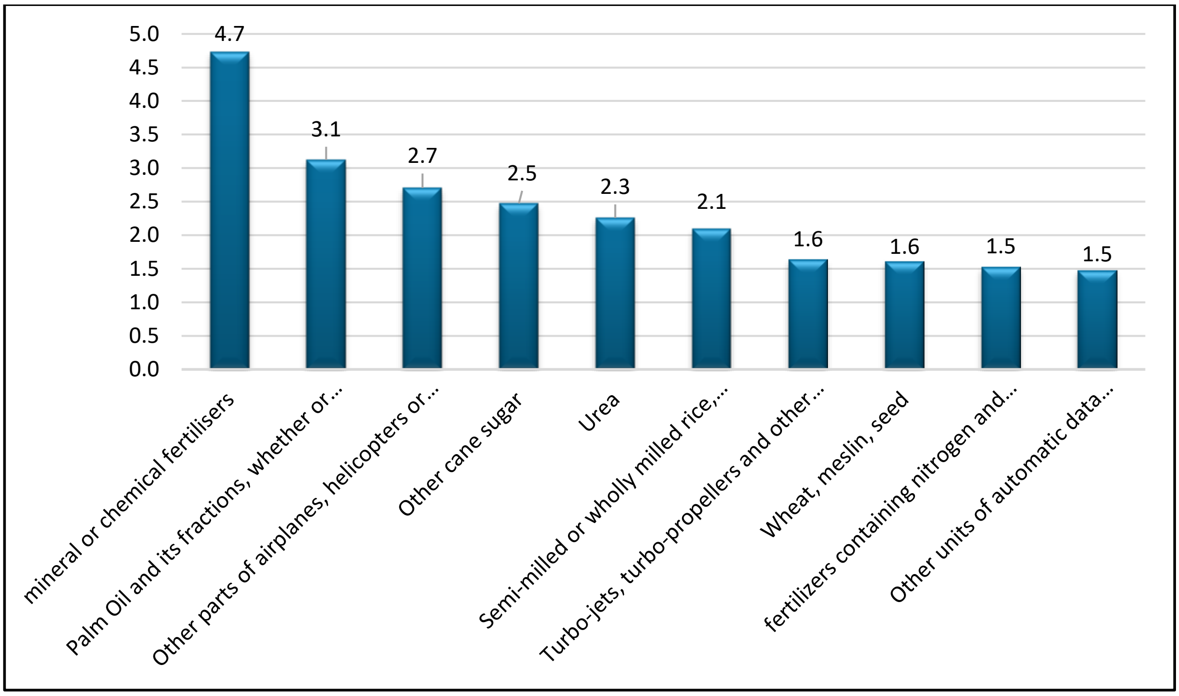
Figure 6 indicates the top ten imports of Ethiopia disaggregated at the HS 8-digit level. Ethiopia's imports are dominated by mineral or chemical fertilizers, palm oil, aircraft parts, sugar, urea, and rice, which together account for 17.4% of total imports. Other important imports include turbojets, wheat, and fertilizers.

Ethiopia is a net importer of agricultural inputs, including fertilizers. Fertilizer is Ethiopia's top import commodity. For instance, the share of imports of mineral or chemical fertilizers is relatively high at 4.7%. This suggests that the country's agriculture is increasingly dependent on imported inputs, which could make it vulnerable to supply-chain disruptions and fluctuations in global prices. The country also depends on imported agricultural products such as wheat, and rice, and processed agricultural outputs such as palm oil. Food products, such as rice, palm oil, and sugar, constitute a significant portion of Ethiopia's imports. This indicates a dependence on foreign sources for food supply, which could be vulnerable to global market fluctuations. This is likely attributed to a confluence of factors, including the domestic agriculture sector's limited productive capacity, which has hindered the sufficient production of essential agricultural goods. Moreover,

[4] The ESS expressed the import values in Ethiopian birr (ETB). These values were converted into USD using the average exchange rate of ETB 56.65 per USD observed in the quarter. The exchange rate can be accessed at https://www.exchangerates.org.uk/ETB-USD-spot-exchange-rates-history-2024.html

Ethiopia's growing population and the country's reliance on imported fertilizers have further exacerbated the need for agricultural imports.

Figure 6: Top ten import products (% share in total imports) of Ethiopia at HS 8-digits, January-March 2024



Source: Computation based on data from ESS (2024)

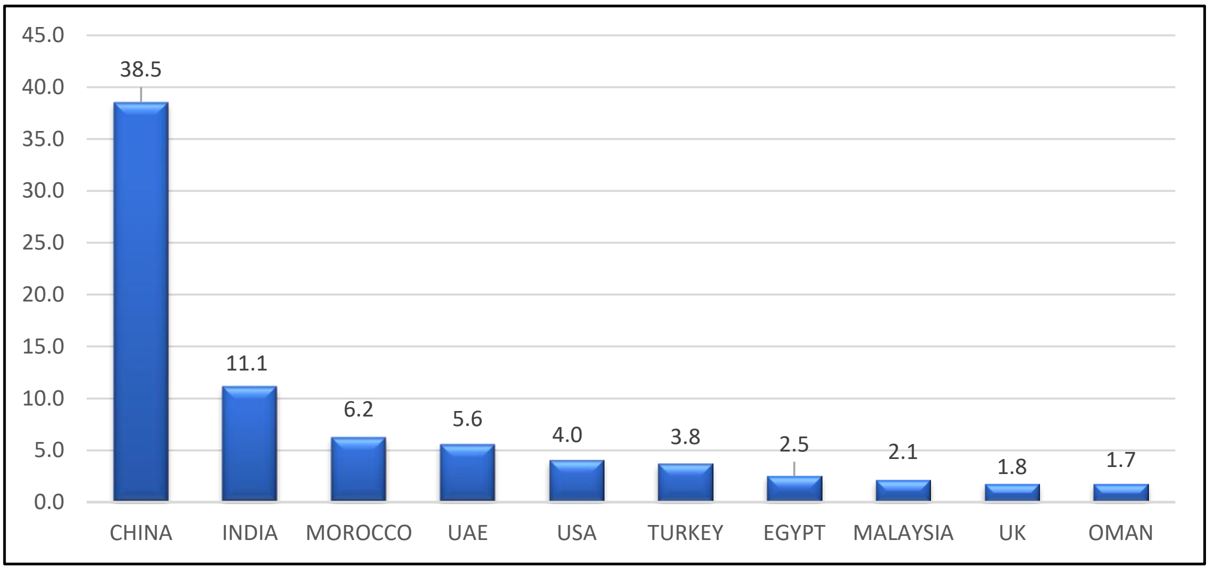
Ethiopia's significant imports of aircraft parts underscore its substantial investment in the aviation sector. Aircraft and aircraft parts together accounted for approximately 4.3% of total merchandise imports during the review quarter, indicating a strong commitment to expanding and modernizing the country's aviation infrastructure. This strategic focus on aviation has positioned Ethiopian Airlines as a key player in the global airline industry and a significant contributor to Ethiopia's foreign exchange earnings. The airline's extensive international network and growing fleet of modern aircraft have solidified its reputation as a reliable and efficient carrier, attracting both domestic and international travelers.

While the top 10 products represent a significant portion of Ethiopia's imports, the relatively small share of each product indicates a diversified import basket, reducing the country's vulnerability to fluctuations in the price of any single commodity.

3.2.2. Major Origins of Imports

Figure 7 shows the top 10 countries from which Ethiopia imports goods in the review quarter.

Figure 7: Top 10 origins of imports (% share in total imports), Jan-Mar. 2024



Source: Computation based on data from ESS (2024)

China is Ethiopia's largest import source, accounting for 38.5% of total imports. This suggests a significant reliance on Chinese goods and services. India follows China, accounting for 11.1% of Ethiopia's imports, making it the second-largest source. Morocco contributes 6.2% of Ethiopia's imports, becoming the third most important source of goods.

The majority of the top 10 import origins (six) are in Asia, accounting for nearly 63% of total merchandise imports. This highlights the region's importance as a supplier of goods to Ethiopia. While China dominates, there is also a significant share of imports from other African countries, such as Morocco (6.2%) and Egypt (2.5%). This indicates that Ethiopia engages in regional trade, which can contribute to economic integration and development. Although China is the primary source, Ethiopia imports from a range of countries in Asia, Africa, Europe, and North America. Such diversified sources can help mitigate risks associated with reliance on a single supplier.

Figure 7 suggests that there is considerable trade dependence. Ethiopia's reliance on imports, particularly from China, suggests a need to diversify its supply sources and promote domestic production to reduce trade dependence. On the other hand, the presence of African countries in the top 10 import origins indicates opportunities for further regional economic integration and cooperation. A significant proportion of imports (63%) are sourced from Asia. This entails that diversifying import sources can help improve supply chain resilience and mitigate the impact of global economic shocks.

3.3. Trade Balance

Ethiopia's trade balance has been negative and widening over the past two decades, suggesting that imports have consistently exceeded its export earnings. For instance, in 2001, the trade deficit was $1.35 billion. The deficit demonstrated strong growth over the years, reaching an all-time high of $14.6 billion in 2022. However, there was a modest improvement in 2023, with the deficit declining to $14.2 billion (EEAb, 2024).

Ethiopia exported goods worth $784.3 million while importing goods worth $6.18 billion in the review quarter. This led to a significant trade deficit of $5.39 billion in the review quarter compared to $4.3 billion in the previous quarter, suggesting that imports far exceeded exports in value. The trade deficit was nearly seven times larger than the value of goods exported. The increment in the trade deficit was mainly due to the significant growth in imports relative to the modest growth in exports.

Ethiopia's trade balance during the review quarter reveals a substantial deficit. This suggests that the country's export size is tiny and heavily reliant on imports to meet domestic demand and industrial needs. This dependence could make the country vulnerable to global economic fluctuations and supply chain disruptions.

The trade balance deficit continues primarily due to the small size of exports compared to the demand for imports and the significant increase in imports exceeding that of exports**.** The growth of imports is expected in an import-dependent and growing small economy. What is concerning is the small size and faltering export performance that contributes further to the widening of the trade deficit. Ethiopia's export sector remains relatively small and has experienced slow growth. Perhaps, UNCTAD's data shows that merchandise exports increased by only $750.8 million between 2012 and 2022. More concerning, Ethiopia's export contribution to the GDP has been on a downward trajectory over the last decade. The size of exports of goods and services as a percentage of GDP declined significantly from 12.7% in 2013 to 6.7% in 2023. This is significantly below the 24% expected from a country the size of Ethiopia at its level of development (World Bank, 2017).

In addition, Ethiopia's chronic trade deficit reveals the problem associated with the structure of exports. Apart from the tiny size of exports, this imbalance may appear to suggest two key issues. First, it is linked to the type of goods that Ethiopia exports—low-value added primary commodities characterized by high price volatility in the global markets. Ethiopia's exports are less complex products produced by most countries and less competitive in international markets. There is no adequate diversity and uniqueness of agricultural commodities to compete in international markets. They rather lead to high export earnings instability and widening trade deficits. Second, demand for imports outpaced export capacity. This might be explained by the lack of industrial capacity to manufacture diversified industrial goods (EEAb, 2024).

To improve its trade balance, Ethiopia should focus on promoting exports and diversifying its export base. This could involve strategies such as diversifying the structure of exports, improving product quality, reducing export/trade costs through streamlining trade procedures, and exploring new markets. In addition, the trade deficit highlights the need for Ethiopia to develop its domestic industries and promote import substitution. By increasing domestic production and exports, Ethiopia can reduce its dependence on imports and strengthen its economy. Ethiopia can consider import substitution strategies to reduce its reliance on imports of essential agricultural products and basic consumption goods. This could involve scaling up initiatives/ strategies such as *Ethiopia Tamrit*' to mean '*let Ethiopia produce'*, and promoting domestic production of goods that are currently imported.

4. Conclusion

Following the reform, the Ethiopian Birr significantly depreciates against the US dollar and other major currencies. Countries like Ethiopia, with insufficient foreign exchange reserves relative to rising forex demand, often face continuous depreciation of their local currency, particularly after floating their exchange rates. Factors such as limited foreign currency supply, currency speculation, economic uncertainty, and overall macroeconomic conditions continue to contribute to the rapid depreciation of the ETB.

The rapid depreciation of the ETB has significantly narrowed the gap between the official and parallel foreign exchange rates. While the adoption of a floating exchange rate regime has further reduced this disparity, the parallel market has not been entirely eliminated. The narrowing parallel market premium indicates a convergence between the official and black-market exchange rates. This trend suggests that aligning the official exchange rate with macroeconomic and market fundamentals can partially balance the supply and demand for foreign exchange, thereby reducing the reliance on the parallel market.

The analysis of the exchange rate spread in Ethiopia's foreign exchange market, particularly following the exchange rate reform, reveals a significant widening of the buy and selling rates spread. This trend is primarily driven by the persistent shortage of foreign exchange, limited export earnings, and high import demand. The resulting limited supply of foreign exchange has led to intense competition among banks. The underdeveloped foreign exchange market, characterized by limited liquidity, further exacerbates the situation. While the market-based exchange rate system offers potential benefits, it also introduces challenges, including increased volatility and wider spreads. Addressing these underlying issues, such as boosting export earnings, diversifying exports, and fostering a more developed foreign exchange market, is crucial to mitigating the negative impacts of a widening spread and stabilizing the exchange rate. Despite the volatility, the post-2024 exchange rate reform in Ethiopia has fostered a more competitive environment for foreign currency transactions among banks. While challenges persist, the potential benefits for both banks and customers are substantial. By offering competitive rates in line with NBE’s regulations, banks can enhance their market position and thrive in this new landscape.

Encouraging more players to enter the foreign exchange market can help drive down buy-selling rate spreads. In this respect, the introduction of non-bank foreign exchange dealers could further intensify competition in the foreign exchange market, potentially leading to increased efficiency and a narrowing of the spread between official and parallel exchange rates. Alongside this, increasing the supply of forex into the economy from donors and remittances shall be emphasized as it is expected to play a critical role in stabilizing the foreign exchange market.

The Ethiopian Birr is rapidly depreciating in the post-reform period. While a gradual approach to floating the exchange rate could have helped mitigate the excessive depreciation, and market volatility and allowed participants to adjust, the NBE may still need to intervene in the initial phases of the reform. The recent policy shift allows NBE to intervene in the foreign exchange market to address malpractices. Government intervention in currency markets is common to mitigate exchange rate volatility's impact on inflation and output. Given this, it's crucial to avoid excessive depreciation of the ETB. Informed interventions can help prevent excessive depreciation, inflationary pressures, a widening trade deficit, socioeconomic crises, and the need for subsequent policy reversals. This intervention could involve injecting foreign exchange supplies through frequent or regular auctions to stabilize the market and prevent excessive volatility.

Overall, the success of currency reforms in Ethiopia will hinge on the government's capacity to simultaneously address chronic supply shortages, ensure sustainable sources of forex, and significantly narrow, if not eliminate, the persistent gap between the official and black-market exchange rates.

Moreover, effective implementation of these reforms will require a comprehensive approach that includes targeted interventions to boost domestic production and exports and foster a more competitive foreign exchange market. Additionally, the government must build trust and transparency in the financial system to encourage confidence in the domestic currency and reduce reliance on parallel markets.

Ethiopia's exports are primarily driven by agricultural products. This highlights the need for continued investment in agricultural development and improvement of productivity to boost export performance**.** Aside from attracting capital and facilitating investment in agriculture, exploring opportunities to export value-added agricultural exports, such as processed coffee and oil seeds, can increase export earnings and create more jobs. The presence of exports like textiles and garments indicates potential for export diversification and growth in the manufacturing sector. Encouraging industrialization can contribute to exports, economic diversification, and job creation.

Diversifying exports to other non-traditional agricultural and manufacturing exports may contribute to narrowing down trade deficit, and employment creation and help mitigate the significant risks of relying on a few agricultural commodities.

In terms of destinations, Ethiopia's export landscape, while heavily concentrated in the Middle East and Africa, demonstrates a commendable degree of diversification across commodity destinations. The presence of significant exports to the United States and India underscores the country's efforts to reduce reliance on any single region. Ethiopia must continue to explore new markets, particularly in regions with high growth potential, such as Asia and Europe. Alongside market diversification, efforts to diversify export products beyond traditional commodities will enhance market resilience and reduce vulnerability to price fluctuations, ultimately contributing to sustained export growth. Strengthening regional trade relationships, particularly within the African continent, can create larger markets and economies of scale.

Ethiopia's significant import surge during the review quarter, occurring amidst a severe foreign exchange shortage and small size of export earnings, underscores a growing demand for imports. This trend exacerbates the country's trade imbalance and exposes it to heightened vulnerabilities.

The reliance on imported fertilizers, food products, and essential goods exposes the country's limited domestic production capacity and weak agricultural sector. This, combined with a significant dependence on China as a supplier of imports, raises concerns about the potential downsides of reliance on a single source and suggests the need for diversification of import sources.

Ethiopia needs to boost domestic production by prioritizing initiatives that increase domestic agricultural output and reduce reliance on imported fertilizers and food products. Initiatives like "*Ethiopia Tamrit"* can be instrumental in achieving self-sufficiency in essential goods.

In addition, diversifying import sources need to be considered by exploring alternative suppliers beyond China to mitigate risks associated with dependence on a single source. In this regard, strengthening regional trade partnerships with African nations to leverage geographic proximity and economic integration is critical. What is more, investing in strategic industries should be given emphasis. This may focus on developing domestic industries capable of producing currently imported goods, such as agricultural goods, inputs, and processed basic consumer goods. This can enhance import substitution, create jobs, and boost the domestic economy.

To improve trade balance and strengthen its economy, Ethiopia should prioritize strategies such as diversifying its export base, enhancing product quality, streamlining trade procedures, and exploring new markets to boost exports. Additionally, promoting domestic production of essential goods and basic consumption items, scaling up initiatives like "*Ethiopia Tamrit*," and investing in domestic industries can reduce import dependency. In this way, Ethiopia can improve its trade balance, mitigate external shocks, and foster sustainable economic growth.

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