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CONFIDENTIAL

November 30, 1984

To: Members of the Executive Board
From: The Secretary
Subject: Ethiopia - Real Effective Exchange Rate - Information Notice

There is attached for the information of the Executive Directors an information notice on a change in the real effective exchange rate of the Ethiopian birr.

If Executive Directors have technical or factual questions relating to this paper, they should contact Mr. G. G. Johnson (ext. (5)8671).

Att: (1)

INTERNATIONAL MONETARY FUND

ETHIOPIA

Real Effective Exchange Rate--Information Notice

Prepared by the African Department and the
Exchange and Trade Relations Department

(In consultation with other Departments)

Approved by A.D. Ouattara and S. Kanesa-Thanan

November 29, 1984

The recent evolution of Ethiopia's real effective exchange rate, as measured by the standard index developed in connection with the information notice system, is set out in the attached table and chart. Based on this index, as of September 1984 the Ethiopian birr had appreciated in real effective terms by more than 10 percent since the last occasion on which the Executive Board had an opportunity to discuss Ethiopia's exchange rate policy--the 1984 Article IV consultation in June 1984. The appreciation is estimated to have amounted to 13.0 percent.

Since February 1973, the exchange rate for the Ethiopian birr has been pegged to the US dollar at the rate of Br. 1 = US\$0.48309. In nominal effective terms the birr has appreciated by 76 percent since 1980, reflecting the strength of the U.S. dollar relative to the currencies of Ethiopia's major trading partners. The significant appreciation of the U.S. dollar relative to most other currencies, coupled with the recently accelerated rate of inflation in Ethiopia (an annual rate of 30 percent over the six months ending September 1984), has led to a real effective appreciation of the birr by almost 50 percent since 1980. The substantial increase in the rate of inflation since March 1984 is a reflection of increasing food scarcity as a result of the current drought, and marks a reversal in the trend of declining prices in Ethiopia relative to those of major trading partners.

The very unfortunate situation now prevailing in Ethiopia is likely to add substantially to the pressure on the balance of payments, as discussed in the Staff Report for the 1984 Article IV consultation (SM/84/102, 5/12/84). The staff understands that the Two-Year Investment Plan (1984/85-1985/86) and the 1984/85 budget have been laid aside as a result of the current crisis, and that a Drought Action Plan and revised budget are being developed. No information on the possible content of the Drought Action Plan or revised budget is currently available.

Staff Appraisal

At the conclusion of the 1984 Article IV consultation on June 8, 1984, the Chairman's Summing-Up observed that "The continued appreciation of the effective value of the birr, as a result of the peg to the U.S. dollar, was seen as difficult to reconcile with the need to strengthen incentives to produce tradeable goods and thereby strengthen the balance of payments position. Directors urged that a more active and flexible exchange rate policy, including the possibility of a different peg for the currency, be considered." In subsequent contacts the staff again stressed the need for a reasonable initial depreciation of the birr to be coupled with depegging from the US dollar. In the absence of appropriate exchange rate adjustments, it will be difficult to stem the rising trend in the external current account deficit, notwithstanding the generally conservative fiscal and monetary policies pursued by the authorities.

Table. Ethiopia: Real Effective Exchange Rate and Related Series

(Indexes: 1980 = 100)

	Real Effective Exchange Rate <u>1/</u> <u>2/</u>	Nominal Effective Exchange Rate <u>1/</u>	Relative Consumer Prices <u>2/</u> (Local Currencies)	Exchange Rate in terms of U.S. dollars <u>1/</u>	Consumer Price Index (Seasonally Adjusted)	Consumer Price Index (Not Seasonally Adjusted)
<u>Quarterly</u>						
1979						
I	106.2	96.6	109.9	100.0	91.5	89.7
II	108.8	98.6	110.3	100.0	94.5	95.1
III	107.2	96.5	111.0	100.0	98.5	100.2
IV	105.0	97.6	107.5	100.0	98.5	97.9
1980						
I	104.1	98.5	105.6	100.0	100.8	99.1
II	102.4	99.7	102.6	100.0	101.2	102.1
III	97.2	99.1	98.0	100.0	99.6	101.0
IV	96.3	102.7	93.8	100.0	98.5	97.8
1981						
I	102.9	108.2	95.0	100.0	103.1	101.4
II	110.3	116.8	94.4	100.0	105.5	106.9
III	115.4	123.9	93.1	100.0	107.0	108.1
IV	111.5	120.6	92.4	100.0	109.0	108.2
1982						
I	116.8	125.7	92.9	100.0	112.1	110.3
II	115.4	129.9	88.8	100.0	109.8	111.4
III	120.5	136.1	88.5	100.0	112.4	113.4
IV	124.5	140.0	88.8	100.0	115.2	114.5
1983						
I	119.7	138.7	86.3	100.0	113.8	112.0
II	119.5	143.8	83.1	100.0	112.0	113.7
III	120.7	150.9	80.0	100.0	110.1	110.8
IV	121.0	154.8	78.1	100.0	110.7	110.0
1984						
I	121.2	157.5	76.9	100.0	111.7	109.9
II	128.9	159.9	80.6	100.0	119.4	121.2
III	138.5	171.7	80.6	100.0	122.1	122.8
<u>Monthly</u>						
1984						
June <u>3/</u>	131.1	161.9	81.0	100.0	120.9	122.7
July	130.3	167.5	77.8	100.0	116.9	117.5
Aug.	135.4	169.8	79.7	100.0	120.9	120.3
Sept.	148.2	175.9	84.2	100.0	128.6	130.7
Percentage change June-Sept. 1984						
	13.0	8.6	4.0	--	6.4	

Source: Information Notice System.

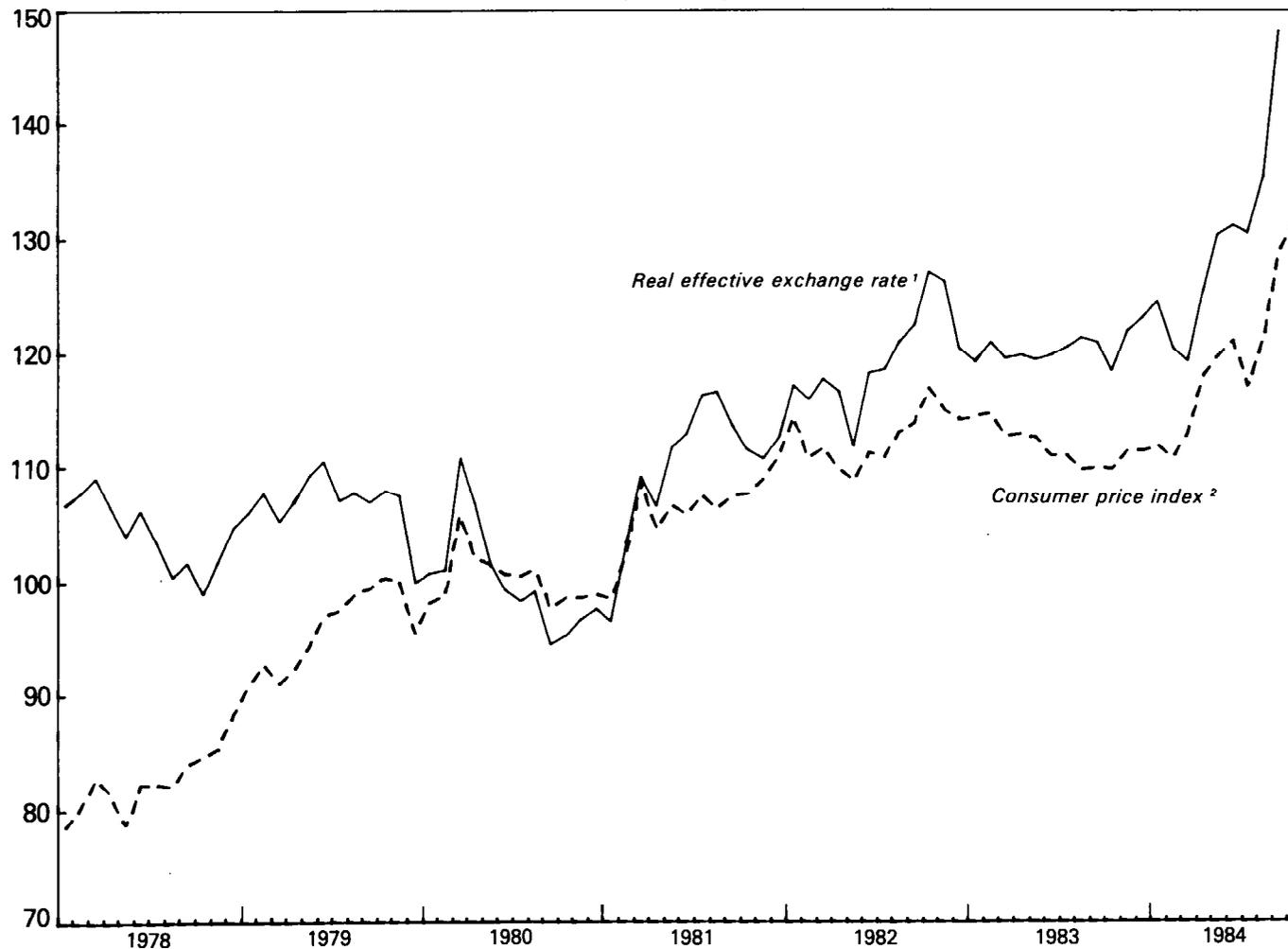
1/ Increases mean appreciation.

2/ Using seasonally adjusted consumer price indexes.

3/ Date of latest consideration by Executive Board.



ETHIOPIA
INFORMATION NOTICE SYSTEM INDEX OF REAL EFFECTIVE EXCHANGE RATE
(1980=100)



¹Trade weighted index of nominal exchange rates deflated by seasonally adjusted relative consumer prices; increases mean appreciation.
²Seasonally adjusted.