



INVESTING IN ETHIOPIA

COFFEE BREAK?

- **Ethiopia's coffee exports are down by 13 percent so far this year, raising questions as to whether a sharp break in the country's main export is just around the corner.**
- **The decline in coffee export earnings is almost entirely due to lower volumes, not lower prices. A major overhaul in the coffee marketing system that took place with the move of coffee trading to the Ethiopian Commodity Exchange (ECX) appears to explain part of the volume decline; however, as the volume decline took place *before* the start of coffee trading on the ECX, other factors also appear to be at work.**
- **The outlook for coffee exports in the coming months will all depend on what exactly follows from recent rather draconian government actions to seize the stockpiles of six large coffee exporters accused of hoarding supplies. In the very near term, export volumes could pick up to the extent that these seized stockpiles are quickly turned into shipments to foreign buyers. However, the longer term consequences of recent official moves in this sector raise many uncertainties and carry high risks**

COFFEE BREAK?

Recently released trade data show that coffee exports amounted to \$222 million in the first eight months of this fiscal year, a 13 percent drop from the same period last year. More than three-quarters of this drop can be explained by lower export volumes, which appears to suggest that internal factors—rather than exogenously set world prices—are responsible for the decline (Table 1).

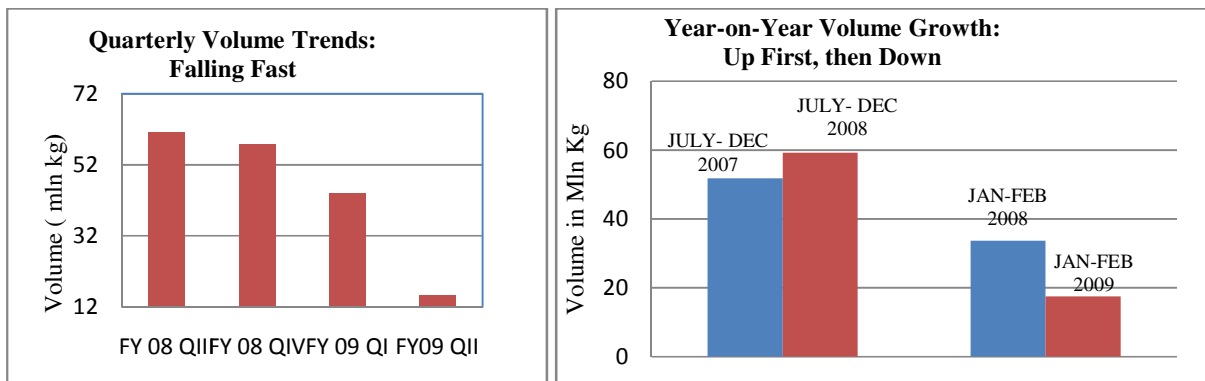
Table 1: Coffee Export Performance So Far this Year; First 8 Months of FY2008-09 vs. FY2007-08

	First 8 months FY2007-08	First 8 months FY2008-09	Growth in Percent
Value (USD millions)	250.9	221.7	-12.8
Volume (Kg millions)	85.4	76.7	-10.2
Price (USD/Kg)	2.93	2.89	-1.4

Source: MOTI and Customs Authority

The drop in coffee export volumes has accelerated in recent months. For the first six months of this fiscal year, coffee export volumes were actually well above those in the same period last year (up by 14 percent). Industry sources indicate that the strong performance in the early part of this fiscal year partly reflected a carry-over from the FY 2008 season which had not been fully shipped out by June 2008. Consistent with this, year-on-year declines in export volumes began to emerge in the months of November and December 2008, with coffee export volumes falling as much as below 15 percent their year-ago levels. The decline accelerated sharply in January and February of 2009 when export volumes amounted to just 7 and 10 million kilograms respectively, down about 50 percent from year-ago levels. The main source of the decline in coffee exports for the first eight months of this fiscal year thus reflects developments in just the past two months, namely in January and February 2009 (Table 2).

Table 2: Coffee Export Volumes

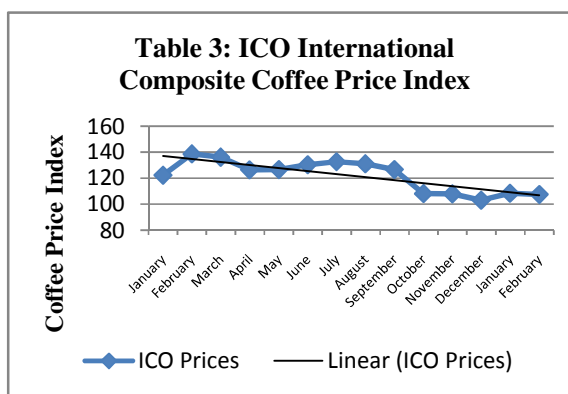


A major overhaul in the coffee marketing system appears to explain at least part of the recent volume decline, though other factors must also be at play. Beginning December 2, 2008, coffee producers, who previously sold their stocks (to exporters) via Ministry of Agriculture sponsored auctions, were required to switch trading towards the Ethiopian Commodity Exchange (ECX). Due to a host of logistical problems, including issues related to warehousing and the speed at which coffee could be graded and processed for storage, the ECX system appears to have been overwhelmed by its client volumes (at least in its initial days). However, the collapse in Ethiopia’s coffee exports started in November 2008, well before the launch of the ECX, suggesting other factors are also at work. Among such factors is the sharp drop in orders from Japan, a major buyer that absorbed a fifth of Ethiopia’s coffee export last year but that temporarily stopped importing coffee from Ethiopia in mid- 2008 due to an export consignment that allegedly contained agrochemicals and pesticides.¹ Some market participants also suggest that there was some stockpiling on the part of exporters who were anticipating a depreciation of the exchange rate (which would provide them with greater Birr returns by delaying their exports to a later date).

¹ This was apparently due to the packaging material, namely the coffee bags, used in the export process. A government directive has since mandated new inspection and quality control measures, including a requirement to replace old coffee bags with new ones.

Declining world prices have also worked to reduce exports, but to a much smaller extent (Table 3). Coffee prices were high for most of 2008, but have fallen since September 2008 in line with the deepening global financial crisis. Fortunately for Ethiopia, coffee prices have not fallen as much as the decline seen for other commodities such as oil and minerals. In fact, only 1½ percentage points of the 13 percentage points of the overall decline in coffee exports is attributable to lower world prices.

Looking ahead, we do not think the outlook for coffee exports will be as bleak as suggested by the most recent monthly data:



- Prices:** Somewhat surprisingly in light of the global economic environment, the outlook for coffee prices has turned positive for the coming months, reflecting supply shocks in some major producer countries such as Colombia. Prices in the first two months of 2009 were already 7 percent higher than the average level seen in the last quarter of 2008. And prices have climbed even further this month, rising by 5 percent in the first 25 days of March (relative to the January-February average).² Futures prices (NYBOT) suggest this trend will continue, and Ethiopian coffee prices are likely to follow suit given the strong historical relationship observed between ICO mild Arabica coffee prices and Ethiopian coffee prices. In fact, based on futures prices, we project Ethiopian coffee prices will move up from around 126 cents/lbs right now to 130 cents/lbs in the coming months (a 3-4 percent jump).³
- Volumes:** The quantity of coffee exported between March and June will be critical since half of Ethiopia’s annual coffee export volumes are normally shipped in just these four months alone. Our overall assessment with respect to the outlook for this period is that monthly export volumes will pick up relative to exports in January-February 2009 (in line with seasonal norms), but will remain well below year-ago levels. In particular, though official numbers are not yet out, March 2009 exports are already showing a sharp drop from last year’s levels according to industry experts familiar with developments in the last few weeks. With respect to the April-June 2009 period, what exactly follows from the recent government actions to take over the coffee stockpiles of the largest exporters is clearly the big unknown. Press reports indicate that the Ethiopian Grain Trading Enterprise (EGTE) is being tasked with exporting these seized stocks and this may work to increase export volumes to the extent that these stocks are very quickly shipped to foreign buyers. But there is a possibility of exactly the opposite effect, namely that shipments of seized stockpiles are delayed as the new operator, EGTE, faces challenges related to logistics, transport, or securing/executing orders from foreign buyers. Though of course difficult to predict, our sense is that export volumes will pick up at least for the very near term (Table 4a and 4b) given the government’s clearly determined approach to boosting supplies of coffee exports, including through the rather extraordinary move of shifting private sector coffee exports to a public enterprise.

Table 4a: Monthly Coffee Exports—Recent Outturns and Access Capital Projections

FY 2009: Export values, volumes, & prices	July 2008	August 2008	September 2008	October 2008	November 2008	December 2008	January 2009	February 2009	Cumulative 8 months	March 2009	April 2009	May 2009	June 2009	Fiscal Year total
Value (USD mns)	56.7	45.7	30.9	20.4	10.2	11.2	19.3	27.5	221.7	61.0	76.6	51.9	51.9	463.1
Volume (kg mns)	18.0	14.9	11.1	7.1	3.7	4.3	7.4	10.1	76.7	22.0	27.0	18.0	18.0	161.7
Price (USD/kg)	3.15	3.08	2.77	2.86	2.74	2.57	2.60	2.73	2.89	2.77	2.84	2.88	2.88	2.87

Source: MOTI and Customs Authority for historical data; Figures for March to June of FY 2008-09 are Access Capital projections.

² Coffee price data from the International Coffee Organization’s (ICO) “other mild Arabica” price series, which most closely tracks Ethiopia’s coffee export prices (see www.ico.org).

³ The expected increase in the ICO price index translates into an increase from 2.77 to 2.86 USD per kilogram based on Ethiopia’s (metric-based) coffee price index.

Table 4b: Monthly Coffee Export Volumes—Comparisons from year-ago levels and Access Capital Projections

VOLUME COMPARISONS: FY 2008 and FY 2009 (In Kg millions)	July	August	September	October	November	December	January	February	Cumulative 8 months	March	April	May	June	Fiscal Year total
Volumes FY 2008	12.2	15.1	6.6	7.9	4.4	5.5	12.7	20.9	85.4	27.4	20.5	19.1	18.2	170.6
Volumes FY 2009	18.0	14.9	11.1	7.1	3.7	4.3	7.4	10.1	76.7	22.0	27.0	18.0	18.0	161.7
Percent Change FY09 vs. FY08	47.5	-1.3	68.2	-10.1	-15.9	-21.8	-41.7	-51.7	-10.2	-19.7	31.7	-5.8	-1.1	-5.2

Source: MOTI and Customs Authority for historical data; Figures for March to June of FY 2008-09 are Access Capital projections. Access Capital projections assume a 20 percent drop in year-on-year exports for March 2009, a year-on-year *increase* in April 2009 (as the backlog of recent months is shipped out), and a slight drop relative to last year's levels in the last two months of the fiscal year.

With respect to broader balance of payments effects, the recent slowdown in coffee exports does not (yet) lead us to alter significantly our expectations for overall export performance this fiscal year. Coffee exports in USD terms will likely be about 11½ percent lower than last year, but the impact of this on total exports will be contained if other key products continue to maintain reasonably strong growth rates. In this connection, it is encouraging that the latest trade data release also showed that *non-coffee exports* grew by 14 percent in the first eight months of this fiscal year (Table 5). Accordingly, we continue to think (as projected in our 2009 Macroeconomic Handbook) that growth in overall exports will lie within the range of 10-15 percent this year—certainly a sharp slowdown from the 25-percent plus growth rates of recent years but still somewhat respectable growth considering the very challenging global economic environment.

Table 5: The Performance of Non-Coffee Exports

	FY07/08 8 months	FY08/09 8 months	Growth, in percent
Total exports	834	889	7%
Coffee exports	251	222	-13%
Non-coffee exports	584	667	14%

Source: MOTI and Customs Authority

Beyond the immediate future, however, the longer term consequences of recent official moves in the coffee sector raise uncertainties and carry high risks. The recent actions to seize the stockpiles of the largest exporters also apparently includes revoking their business licenses, implying that the normal marketing chain for coffee could be disrupted considerably for the next season (all the more so given that the six exporters whose stocks were seized reportedly account for a very sizeable share of the country's coffee exports). If these actions are temporary and the major players rejoin the sector soon after this incident, then risks for the next season could be minimal. However, there is a possibility that the major players stay out of the exporting business for a very prolonged period (or even for good), in which case risks to next year's exports will be substantial. Also, to the extent that the 'short-term fix' taken on the part of the government leaves unaddressed the apparent grievances of coffee exporters (e.g. certain aspects of ECX operations as well as the level of the exchange rate), a lasting solution will not have been put in place.⁴ The authorities' policy choices and direction in the coming months will thus clearly be the main determinant of the longer-term outlook not just for coffee exports but also for the country's foreign exchange conditions more broadly.

⁴ An exchange rate adjustment would raise incentives for exporters to ship out their existing stocks and have the effect of shifting sales away from the domestic market and towards external markets. For example, a depreciation of around say 15 percent (roughly the present gap between the official and reported parallel market rate), would very quickly make selling to foreign buyers 15 percent more profitable for an exporter compared to allocating coffee sales to the domestic market.