ERITREA

Table 1	**2019**
Population, million	3.5
GDP, current US$ billion	2.0
GDP per capita, current US$	566.7
School enrollment, primary (% gross)[a]	68.4
Life expectancy at birth, years[a]	65.9

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent WDI value (2018).

The pandemic shock is expected to reduce real growth to -0.6 percent in 2020, after an estimated rebound to 3.7 percent the year before. High expenditure rigidity prevented a larger fiscal response to the crisis, and the widening fiscal deficit is financed largely through monetization. The speed of the recovery will depend on delays caused by COVID-19 in finalizing two large mines. Poverty data, like national accounts information, have not been produced over the last decade.

Key conditions and challenges

Eritrea has started emerging from a decade of international isolation, and two decades of mobilization. While UN sanctions have been lifted, transitional political arrangements are still in place and focused on security. Meanwhile, progress has stalled in establishing relations with development and international partners. Moreover, efforts to shift from a centrally planned to a market-led economy have been slow and sporadic, and large SOEs dominate economic activity. Monetary policy is characterized by administrative measures, fiscal dominance, and a fixed exchange rate regime pegged to the US dollar, with foreign exchange reserves hovering around 2 months of imports. The banking system is mostly lending to the government, lacking international correspondence banks, while payment and settlement systems are absent. The country is among the most vulnerable and least adapted to climate change, and frequent weather shocks pose a heavy burden for the economy and rural livelihoods. Agricultural output has barely exceeded 80 percent of annual food requirement even in years of bumper harvest. The mining sector, which started operating in 2011, accounts for over 90 percent of total exports, yet contributions to budget revenues are limited.

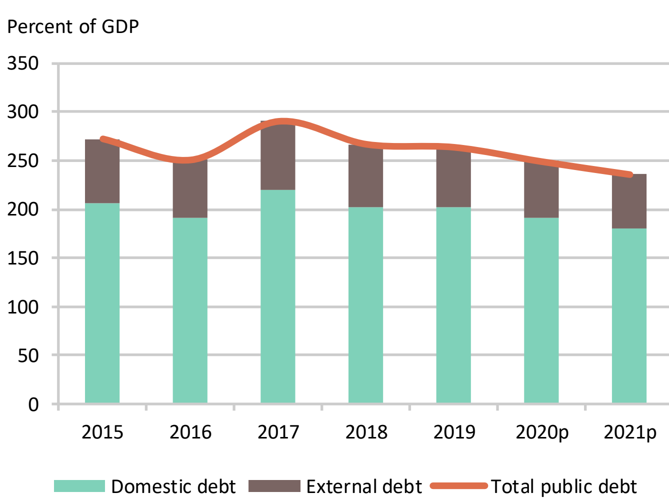
The emergency conditions prevailing in the country over the past decade have led to data production capacity constraints. Specifically, national accounts data are limited to unofficial GDP estimates by the Ministry of Finance, while inflation is estimated only for the capital, Asmara. The last population census in Eritrea took place more than 25 years ago. Little is known about poverty; data from 1996/97, covering only urban areas, suggests that poverty was widespread with around 70 percent of the population living in poverty.

Recent developments

Hit by the COVID-19 crisis, real GDP growth is expected to plummet to -0.6 percent in 2020 from 3.7 percent a year ago. A lockdown that lasted for several months and border closures have adversely affected domestic demand and aggravated the effects of the external shock. Deflationary pressures, aggravated by the temporary opening of borders with Ethiopia in 2019, have eased and inflation is expected to reach 4.5 percent in 2020.

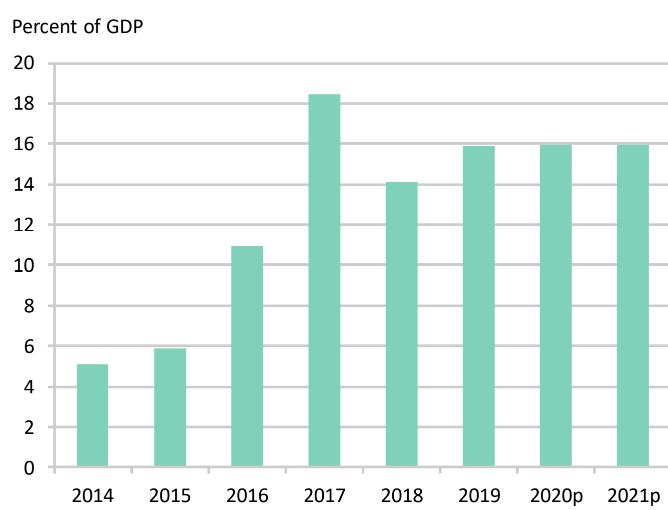
The external current account surplus is set to narrow to 9.5 percent of GDP in 2020 from 12.1 percent last year as the compression in commodity exports exceeds the mild slowdown in imports. Imports are constrained and officially undertaken exclusively by the government, but informal net imports are flourishing. A reduction in inflows of remittances has also contributed to a narrowing of the external surplus. External public borrowing is severely constrained given the build-up of arrears and

FIGURE 1 **Eritrea** / Evolution of total public debt (in percent of GDP)



Source: Ministry of Finance.

FIGURE 2 **Eritrea** / Wage bill (in percent of GDP)



Source: Ministry of Finance.

cannot help building official foreign exchange reserves, which will continue to hover around two months of imports.

Meanwhile, the containment measures reduced fiscal revenues, which is expected to widen the fiscal deficit to 5 percent of GDP in 2020 from 1.5 percent a year ago. Current spending remained broadly unchanged from last year, with the wage bill accounting for half of the outlays. The new salary structure introduced in 2014 for about half of the government employees resulted in the total wage bill more than tripling to 16 percent of GDP by 2020 since 2016. Capital spending remains limited, although some public investment in dams and roads is taking place off-budget, which may represent a contingent liability for the budget. Aided by debt relief provided by the Abu Dhabi Fund, total public debt, including external arrears, is expected to shrink to an estimated 250 percent of GDP in 2020 from 290 percent in 2017. Nevertheless, fiscal and domestic debt outcomes remain uncertain given frequent data revisions due to reporting lags driven by widespread manual processes.

Outlook

The international re-integration of the country could provide for a promising growth outlook, coupled with two new large mines becoming operational over the medium term. Real output growth is projected to rebound to 3.5 percent in 2021 and increase further to 5.5 percent in 2022, with both mines exhibiting sizable output capacity. The government is also taking steps toward ensuring spillover effects from the new potash mine to local fertilizer production. Increased utilization of fertilizer by farmers together with reforms creating more space for the private sector in agriculture could raise agriculture productivity and strengthen output growth. That said, the challenging macroeconomic situation together with the hiatus in engaging with development partners, compounded by climate change and uncertainties regarding the impact of the pandemic on trade and commodity prices, as well as limited opportunities for private sector development under existing policy environment, could dampen growth prospects.

The steady decline in non-tax revenues together with wage-related and other recurrent spending pressures, combined with few opportunities for external borrowing, imply limited options to scale up capital spending in the near term. As accumulated revenues from the Eritrean Petroleum Corporation are depleted, non-tax revenues could decline significantly over the medium term exerting upward pressure on the budget deficit. Efforts to normalize the country's relations with the international community could result in a pathway to reduce significantly external arrears and provide much-needed external financing. The latter would help boost reserves in the shorter term and secure foreign exchange for imports to build infrastructure. In parallel to addressing external arears, the government needs to resolve the massive domestic public debt stock and resuscitate the financial sector. Both are likely to impose a substantial financial burden on the budget.

TABLE 2 Eritrea / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2017	2018	2019	2020 e	2021 f	2022 f
Real GDP growth, at constant market prices	-10.0	13.0	3.7	-0.6	3.5	5.5
Private Consumption	-11.2	13.2	5.6	-1.6	5.5	8.8
Government Consumption	9.2	0.8	39.3	16.1	5.5	7.0
Gross Fixed Capital Investment	12.0	-62.8	67.5	151.6	14.2	-8.5
Exports, Goods and Services	29.8	8.9	-5.2	-17.2	6.2	7.1
Imports, Goods and Services	-4.6	18.7	6.8	-11.1	5.1	7.7
Real GDP growth, at constant factor prices	-10.2	12.8	3.7	-0.7	3.6	5.5
Agriculture	-18.2	24.0	27.0	-0.5	5.8	3.1
Industry	-14.4	11.1	13.0	-0.7	1.4	10.2
Services	1.6	4.9	-26.0	-1.0	2.5	4.0
Inflation (Consumer Price Index)	-13.3	-14.4	-16.4	4.5	2.4	2.0
Current Account Balance (% of GDP)	24.0	15.4	12.1	9.5	9.5	8.9
Net Foreign Direct Investment (% of GDP)	2.9	2.9	3.9	3.8	3.5	3.4
Fiscal Balance (% of GDP)	-5.7	4.3	-1.5	-5.0	-4.7	-1.5
Debt (% of GDP)	290.4	267.1	264.0	249.5	236.4	217.6
Primary Balance (% of GDP)	-3.6	5.7	0.2	-3.4	-3.1	0.1

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate. f = forecast.