

Recent macroeconomic and financial developments

Eritrea was affected by a locust invasion and the COVID-19 pandemic, which combined to impede economic activity in 2020. Real GDP is expected to decline by 0.6%, compared with growth of 3.8% in 2019. Pandemic-related disruptions of supply chains and working hours, and containment measures such as travel restrictions hurt growth. Subdued private consumption and investment, together with reduced net exports, also contributed to the decline in GDP. After deflation of 16.4% in 2019, prices rose 4.7% in 2020—in part because of COVID-19-induced disruptions in regional and global supply chains. The fiscal deficit widened to 5.2% of GDP in 2020, compared with 1.6% in 2019. The deterioration was due to increased public spending to mitigate the impact the pandemic at the same time that revenues fell. The fiscal deficit was financed by drawing down government deposits with the central bank and concessionary borrowing. The current account surplus decreased to an estimated 10.1% of GDP in 2020 from 12.1% in 2019, reflecting a narrowing savings–investment gap, as savings dropped in line with subdued economic activity. The excess savings relative to investments reflects in part a business regulatory environment that has not been conducive to investment and job creation. Poverty remains pervasive, as the working poor (with incomes below \$3.10 a day at purchasing power parity) are estimated to account for 75.2% of total employment.

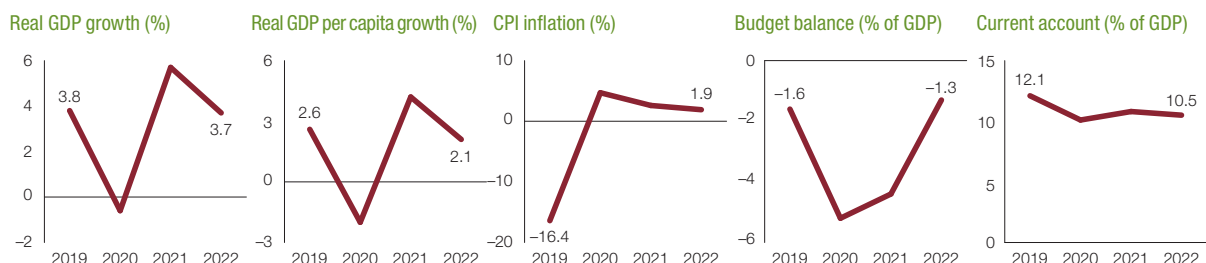
Outlook and risks

The outlook is positive, with real GDP growth projected to recover to 5.7% in 2021 before moderating to 3.7% in 2022. Economic recovery will be driven by a rebound in metal exports following a gradual improvement in global demand and prices. A recovery in private consumption and increased investment demand are expected to support growth in 2021. The ongoing civil disturbance in the

Tigray region of neighboring Ethiopia, climate change shocks, and limited financial inflows constitute the main downside risks to growth. Inflation is projected at 2.6% in 2021 and will decline to 1.9% in 2022, as domestic production continues to expand. The fiscal deficit is projected to narrow to 4.4% of GDP in 2021 and to 1.3% in 2022, as domestic revenues grow in tandem with the economic recovery. The current account surplus is projected to increase to 10.8% of GDP in 2021 before moderating to 10.5% in 2022, driven by fluctuations in national savings. Poverty and income inequality are expected to worsen because the services sector, which accounts for 30.3% of total employment, was most affected by the COVID-19 containment measures. A global economic recovery will boost remittance inflows, a key source of livelihoods in Eritrea, and mitigate the severity of poverty and income inequality.

Financing issues and options

Eritrea's gross public debt reached 189.2% of GDP in 2019, up from 185.8% in 2018, and the country is in debt distress. The growth in gross public debt was driven by primary deficits and high real effective interest rates, with real GDP growth partially offsetting the buildup in public debt. Gross public debt is projected to decline to 185.6% of GDP in 2020 and 165.7% in 2022, due to government efforts to accelerate debt servicing. Strong policy adjustments, notably fiscal consolidation will be beneficial, but debt restructuring is necessary to ensure a gradual return to debt sustainability. The Quality of Policies and Institutions score, as measured by the Country Policy and Institutional Assessment, is less than 2.69, reflecting weak capacities, including debt management. In this context, high economic growth involving greater participation of the private sector and fiscal reforms—notably domestic resource mobilization, fiscal consolidation, and institution strengthening—should be an integral part of policy measures to ensure debt sustainability.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team. Data on the budget balance correspond to Eritrea's fiscal year, which runs from July 1 to June 30.