9.1 International Economic Developments

9.1.1 Overview of World Economy

Global economic expansion is estimated to moderate to 4.3 percent in 2005 from 5.1 percent in 2004, reflecting both a return to a more sustainable pace of expansion and the adverse impact of higher oil prices. This expansion, however, was unbalanced among regions. Strong growth has been registered in the United States, China and in most of emerging market and developing countries. In contrast, growth in Europe and Japan has been disappointing driven by faltering exports and weak domestic demand [World Economic Outlook, April 2005].

Table 9.1 :- Overview of the World Economic Outlook and Projections

(Annual Percentage Changes)

			Projection	
	2003	2004	2005	2006
World Output	**4.0**	**5.1**	**4.3**	**4.4**
Advanced Economies	2.0	3.4	2.6	3.0
United States	3.0	4.4	3.6	3.6
Euro Area	0.5	2.0	1.6	2.3
Japan	1.4	2.6	0.8	1.9
Other Emerging markets and Developing Countries	6.4	7.2	6.3	6.0
World Trade Volume (goods & services)	**4.9**	**9.9**	**7.4**	**7.6**
Imports				
Advanced Economies	3.6	8.5	6.5	6.3
Other Emerging Markets and Developing Countries	8.9	15.5	12.0	11.0
Exports				
Advanced Economies	2.8	8.1	5.9	6.8
Other Emerging Markets and Developing Countries	10.7	13.8	9.9	9.7

Commodity Prices				
Oil	15.8	30.7	23.2	-5.9
Non-oil	7.1	18.8	3.8	-5.1
Consumer Prices				
Advanced Economies	1.8	2.0	2.0	1.9
Other Emerging Markets and Developing Countries	6.0	5.7	5.5	4.6

Source: World Economic Outlook, April 2005

Output growth in advanced economies is projected at 2.6 percent in 2005 from 3.4 percent in 2004. Among industrial countries, the US economy continued to grow at above trend level and expected to record a growth rate of 3.6 percent, on account of strong domestic demand. Growth in the euro area and Japan, which together accounted for nearly one-fourth of global output is insignificant

In the Euro area, GDP growth is estimated to decline to 1.6 percent in 2005 from 2 percent a year earlier, mainly due to high and volatile oil prices, long standing structural weaknesses and the appreciation of the euro that subdued domestic demand.

The Japanese economy is expected to grow by a mere 0.8 percent in 2005, compared to a robust growth of 2.6 percent in 2004, on account of weak global demand for IT products, declining consumption spending and appreciation of the Yen.

GDP growth in emerging Asia picked up to 7.8 percent in 2004 and projected to grow by 6.9 percent in 2005, reflecting a return to more sustainable levels, the moderation of the global expansion and higher oil prices. In spite of the recent tightening measures by the authorities, China's economic momentum remains very strong. China recorded a growth rate of 9.3 and 9.5 percent in 2003 and 2004 and is projected to grow by 8.5 and 8 percent in 2005 and 2006, respectively.

Sub-Saharan Africa recorded a GDP growth rate of 5.1 percent in 2004, underpinned by prudent macroeconomic policies, buoyant commodity prices, improved weather conditions, easing external debt burdens through the Heavily Indebted Poor Countries (HIPC) initiative and somewhat better access to industrial country markets. In 2005, GDP growth is projected to remain robust (5.6 percent growth), spurred by continued strong growth in oil producing countries and favourable weather conditions. Despite these encouraging developments, Africa is still likely to fall well short of the Millennium Development goal targets. The key challenge is strengthening of institutions and governance at the national level and getting financial and technical assistance from international community including elimination of barriers to exports, particularly agricultural products.

9.1.2 World Trade

The volume of goods and services traded in 2004 expanded by 9.9 percent and is projected to increase by 7.4 and 7.6 percent in 2005 and 2006 respectively. Imports of goods and services by advanced economies rose by 8.5 percent in 2004 and subdued to 6.5 percent in 2005. On the other hand, exports of goods and services from emerging and developing countries increased by 13.8 percent in 2004 and is projected to expand by 9.9 percent in 2005. According to World Economic Outlook, April 2005, global current account imbalances have been widened. The US current account deficit is estimated at a record 5.7 percent of GDP in 2004 despite the significant nominal effective depreciation of the dollar over the past three years. This widening of the deficit is partly explained by faster growth in the United States relative to its advanced economy trading partners over the same periods, and higher oil prices. This is matched by current account surpluses in emerging Asia, Japan, the oil producing countries in the Middle East and to some extent-the Euro area. As one country’s deficit is another country’s surplus, a reduction in global imbalances calls for a shared responsibility. For instance, domestic demand has to grow more slowly than GDP in the United States, while domestic demand need to grow faster than GDP in surplus countries. This will likely need to be accompanied by a further depreciation of the US dollar over the medium term, and by appreciations elsewhere-including in a number of countries in emerging Asia.

In a related development, the ending of World Textile Quotas (that had been limiting trade in textiles and clothing for the past 40 years) effective January 1,2005 will pose a major challenge for many poor countries in Africa, South Asia, and Central America. The quota system ended up protecting the export markets of the less competitive developing country exporters. Thus, some countries may face balance of payments pressures stemming from the liberalization as well as significant adjustment costs. While developing countries overall are expected to benefit significantly from the ending of textile quotas in terms of exports and employment, the gains will be distributed unevenly. Only a handful of countries, in particular, China, India and Pakistan may end up reaping the benefits of liberalization.

9.1.3 Inflation and Commodity Prices

Inflation and inflationary pressures remain relatively subdued in 2004. In none of the G-7 countries did the inflation exceed 3 percent (and in Japan, of course deflation persisted). Since 2000, annual global headline and core inflation (based on CPI excluding energy products) has averaged about 3 percent. From end-2004, with global output growing rapidly and commodity prices rising sharply, headline inflation turned up significantly, although it still remains moderate. A key question for monetary policy makers is whether the recent rise in both headline and core inflation will be one-off in nature, or whether it could feed through to wages and thereby become more entrenched (World Economic Outlook, September 2004).

Consumer price inflation in advanced economies is estimated at 1.9 percent in 2006 against 2.0 percent in 2005. Similarly, CPI inflation in emerging and developing countries is projected to slowdown to 4.6 percent in 2006 from 5.5 percent in 2005.

The average price of oil is projected to increase by 23.2 percent in 2005 and reached USD 46.50 per barrel from USD 37.76 per barrel in 2004, driven by continued strong demand, uncertainties about organization of the Petroleum Exporting Countries (OPEC) production plans, and falling non-OPEC supply. As of early April, the spot oil price stood at USD 52.96 a barrel owing to robust global demand for crude oil, a cold weather snap in the northern hemisphere, and a limited spare capacity among OPEC producers.

The key factor behind the robust growth in oil demand is the continued increase in consumption of crude oil in United States followed by China. In case of China, severe electrical power shortages encouraged the use of stand-alone, diesel-powered back-up generators. With regard to the supply side, average daily crude oil production from non-OPEC sources rose by about 1.1 million barrel per day in 2004. The growth was, however, held back by significant declines in OECD production of about 0.35 million barrel per day, arising from damaged oil infrastructure caused by Hurricane Ivan, and structural declines in United Kingdom and Norway.

Year 2004 witnessed divergent movements in non-energy commodity prices. Cotton & soybeans prices eased by 34 percent and 21 percent, respectively. On the other hand, sugar, rice, pork and coffee prices all rose by at least 30 percent. Prices of non-fuel commodities have leveled off since mid-2004, with rising beverage and metals prices offset by falling prices of some food and agricultural raw materials, most notably cotton.

Non-fuel commodity prices, on average, are projected to rise by 3.8 percent in 2005. In 2006, however, they are expected to decline by 5.1 percent owing to favourable harvests and weaker demand resulting from higher metal prices.

9.1.4 Exchange Rates

Over the past three years, the US dollar continued to depreciate against the Euro and Pound Sterling, mainly driven by market concerns about the medium term sustainability of the US current account deficit. The US dollar depreciated from USD 1.131/Euro in 2003 to USD 1.243/Euro in 2004 and further to USD 1.314 in 2005. With respect to Pound Sterling, it depreciated to USD 1.887 per pound in 2005 from USD 1.634 per pound in 2003.

9.1.5 External Debt

Total external debt of emerging market and developing countries is estimated to increase to USD 3046 billion in 2005 from USD 2896 billion in 2004 and is projected to rise further to USD 3207 billion in 2006. Nevertheless, the debt burden of this region, as measured by the ratio of external debt to GDP, tended to decline over the recent year. The ratio of external debt to GDP declined from 38.3 percent in 2003 to 34.3 percent in 2004 and further to 31.6 percent in 2005. It is projected to fall to 30.7 percent in 2006.The ratio of external debt to exports of goods and services stood at 92.7 percent in 2004. In 2005, it is estimated to slowdown to 83.1 percent. However, the ratios vary across the regional groups. The ratio was highest in Western hemisphere (151.9 percent) followed by Africa (99.6 percent) and central and Eastern Europe (94.1 percent). On the other hand, developing Asia and Middle East countries recorded lowest ratios of external debt to exports of goods and services, namely 60.6 percent and 64.1 percent, respectively.

Debt service payments as percent of exports of goods and services also declined to 13 percent in 2005 from 14 percent in 2004 and 17.9 percent in 2003, presumably associated with HIPC debt relief.

9.1.6 Capital Flows

Notwithstanding the estimated net official capital outflows of USD 58.3 million in 2005, net capital inflows to emerging and developing countries is estimated at USD 161.6 billion, largely driven by a net private capital inflows of USD 197 billion. Net private capital inflows has increased over time and is projected to reach USD 212.1 billion in 2006 spurred by a substantial increase in net foreign direct investment. Net foreign direct investment is projected to increase to USD 199.8 billion in 2005 and further to USD 203.5 billion in 2006 from USD 167.3 billion in 2004.

Net private capital flows to Sub-Saharan African countries, on the other hand, is estimated at 15.6 billion in 2005, a record high level for the last eight years. It is projected to decline to USD 13.9 billion in 2006.

9.2 Implications of International Economic Developments on the Ethiopian Economy

The continued global expansion accompanied by increases in the volume of world trade, all other things constant, would increase the international demand for Ethiopian products. Nevertheless, the slackened economic growth in the Euro area and deflationary pressures in Japan, which are Ethiopia's main trading partners, is likely to have dampening effect on Ethiopian exports. The strong economic upturn expected in the Euro and Japan in 2006, however, may improve the demand for Ethiopian goods in the coming year.

The subdued inflation and inflationary pressures at the global level calls for the need to contain domestic inflation so as to maintain the competitiveness of the export sector. On the other hand, the upsurge in the international crude oil prices is expected to widen the trade deficit of the country, as Ethiopia's fuel import accounts for over 15 percent of total merchandise imports. This will impose pressures on the current account balance of the country. Another effect of oil price increase is its full or partial pass-through effect to domestic prices. Higher oil prices can affect the real disposable income of households through increased cooking and transportation costs. Moreover, higher oil prices can reduce the competitiveness of some economic sectors that heavily depend on petroleum products in their production process.

The continued depreciation of the US dollar and the corresponding appreciation of the Euro is likely to result in the depreciation of the real effective exchange rate of the Birr, thereby improving the external competitiveness of the country, particularly vis-à-vis Europe, its major export market.

Divergent movements in non-energy commodity prices would also have different implications on export earnings of the country. An estimated 30 percent increase in the prices of non-fuel commodities in 2004, particularly coffee, Ethiopia's dominant export item, would mitigate the adverse impacts of higher oil import prices. A record low prices for cotton products, on the other hand, would reduce export earnings from cotton, thereby widening external current account deficits.

Even though textile and clothing exports account for a small share of exports in Ethiopia, the lifting of the remaining quota restrictions on trade in textiles and clothing effective January 1,2005, is likely to pose Ethiopia to more competitive situations from China and

India in the U.S. and EU markets. Although preferential access under the AGOA and the EBA may help Ethiopia to increase its exports, the removal of the quota will increase the vulnerability of Ethiopia's exports. The removal of textile quota and the likely expiry of the AGOA provision in 2007, that allows the least developed countries to use "third party" fabrics presumably discourage foreign investment that has originally been attracted to Ethiopia to circumvent the quota and reap the benefits of AGOA provision.

9.3 Highlights of Important International Meetings*

9.3.1 Meeting of the Intergovernmental Group of Twenty-Four

During their meeting held on April 15,2005 at Washington, D.C, Ministers of the Inter-Governmental Group of Twenty-Four on International Monetary Affairs and Development welcome the continued global expansion, which is driven mainly by strong growth in the United States, China, and most emerging market and developing countries. The Ministers, however, expressed their concern about the increasingly unbalanced nature of the global expansion, a tightening of financial market conditions, and a sharp increase and volatility in oil prices. Another area of their concern was the widening of global current account imbalances, which increases the risk of disruptive movements in the exchange rates of the major currencies and in interest rates.

The Ministers suggested fiscal consolidation in the United States, further structural reforms in Europe and Japan (so as to boost growth and domestic demand), and greater exchange rate flexibility in emerging market Asia as the strategy of addressing global imbalances.

Ministers note that growth in emerging market and developing countries has been robust, reflecting improved policy performance and favorable international conditions. However, they noted that growth prospects in many countries, particularly the low-income countries, are clouded by high and unsustainable public debt levels. This calls for continued attention to prudent macroeconomic and debt management policies in these countries, as well as a concerted effort by the international community to increase debt relief and concessional financing, including grants. This must also be accompanied by efforts to open industrial country markets to developing country exports and to remove agricultural subsidies.

With regard to crisis prevention, Ministers stressed that given the volatility of capital flows and the risk of contagion, the IMF's toolkit for crisis prevention should include a precautionary facility with ample access to help prevent capital account crises. The Ministers noted that the absence of such a facility at present compels emerging market and developing member countries to accumulate excessive international reserves, which is a costly and inefficient form of self-insurance against financial crises.

Noting the dependence of many low-income countries on the exports of a few commodities, Ministers reiterate the importance of putting in place mechanisms to reduce the vulnerability of these countries to commodity price shocks. Moreover, they call for an early reform of the

IMF's Compensatory Financing Facility to make it more accessible.

Concerning the attainment of Millennium Development Goals, Ministers agreed that despite the improved growth performance of developing countries in recent years, achieving the MDGs remains an enormous challenge, particularly in sub-Saharan Africa. They call on the World Bank, as well as other multilateral institutions and bilateral donors, to further increase their assistance to African countries to support their efforts to meet the MDGs and to implement the NEPAD action plan, especially with regard to investment in infrastructure. Ministers also call on the IMF and the World Bank to step up efforts to help mobilize additional resources to attain the MDGs, including through the various innovative financing proposals that have been put forward recently, such as the International Finance Facility (IFF).

Ministers welcome the efforts of the Fund and the Bank to develop a debt sustainability framework for low-income countries, but expressed their concern about the adoption of a standardized debt framework with excessive conservatism in setting debt sustainability thresholds. In the context of insufficient grant financing, this will limit developing countries' access to borrowing and force larger upfront fiscal adjustment, retarding the progress toward the achievement of the MDGs. Ministers stress that the new debt sustainability framework should build on the lessons learnt from the HIPC Initiative to make debt sustainability assessments more transparent and encouraged consideration of further debt relief for low income countries.

Ministers reaffirm the importance of successfully concluding the Doha Round of multilateral trade negotiations, which will help to promote global economic growth and thus contribute to poverty reduction and the achievement of the MDGs. Ministers call on the BWIs and the WTO to improve coordination in trade policy formulation and urged the World Bank and other multilateral development banks to intensify their financial and technical support for trade facilitation in developing countries.

Ministers emphasized that IMF surveillance should focus on the implementation of trade policies of both industrial and developing countries, and that IMF and World Bank research should evaluate the impact of trade restrictions and sanctions, and domestic subsidies to agriculture on global development and welfare. Ministers underscored that improved access to industrial country markets—particularly through a reduction of tariff and non-tariff barriers and the phasing out of agricultural and other subsidies, which hamper growth in developing countries—would help to promote trade liberalization among developing countries.

Ministers noted that ownership and broad-based support are critical for the success of economic reform programs in emerging markets and other developing countries. In this regard they urge the IMF to support home-grown country programs that reflect countries' own priorities and include clear monitoring procedures, and which could provide a positive signal for donor support. Ministers urge the IMF to develop an instrument that would support such home-grown programs.

As far as the role of the World Bank is concerned, Ministers reiterate the crucial need for the World Bank to focus on poverty reduction and other MDGs. Nevertheless, they expressed their concern about the sharp increase in net negative transfers to developing countries from the multilateral development banks, particularly the World Bank in recent years. They welcome the World Bank's Middle-Income Country Action Plan to reverse this trend and the successful conclusion of the IDA 14 Replenishment negotiations. They also stress the critical role of infrastructure investments in poverty alleviation and the need for increased funding in this area.

Ministers also urged the Bank to take effective action to reduce the financial and non-financial costs of doing business with the Bank, including by clarifying policies, simplifying procedures, streamlining internal processes, and reducing conditionality in lending operations. While acknowledging the need for the Bank to focus on compliance with operational policies, Ministers believe that such focus should be complemented by capacity-building efforts and greater use of own-country systems. Ministers call on the World Bank to develop instruments that are more responsive to country needs, such as structuring financial products to address capital market and commodity related risks.

Regarding governance of the Bretton Woods Institutions, Ministers note that the BWIs' governance structures have not evolved in line with the increased size and role of emerging market, developing, and transition countries in the world economy. Ministers stress the need for concrete actions to reduce the democratic deficit and enhance the voice and participation of developing countries in decision-making at the IMF and World Bank through the development of a new quota formula that would give greater weight to measures of gross domestic product in terms of purchasing power parity, and take into account the vulnerability of developing countries to commodity price movements, the volatility of capital movements, and other exogenous shocks. The upcoming 13th General Review of IMF Quotas is expected to provide an important opportunity to make concrete progress on issues of quotas, voice, and participation

* Extracted from the respective Communiqués.

9.3.2 Meeting of the International Monetary and Financial Committee

The International Monetary and Financial Committee welcomes the continuing global economic expansion, underpinned by supportive macroeconomic policies, improving corporate balance sheets, and benign financial market conditions. The Committee noted, however, that widening imbalances across regions and the continued rise in oil prices and oil market volatility have increased risks. The potential for a sharper-than-expected rise in long-term interest rates from their very low levels and for increased exchange rate volatility also calls for vigilance. The Committee emphasizes that in the coming months IMF surveillance should focus on promoting policies for reducing global imbalances over time; addressing the impact of higher oil prices, in particular on the most vulnerable countries; managing the policy response to potential inflationary pressures; and ensuring the sustainability of medium-term fiscal frameworks.

The Committee envisaged that the conditions in the oil market would remain tight in the medium term, reflecting strong global demand, low excess capacity, and supply concerns even after investments in some countries. It underscores the importance of stability in oil markets for global prosperity, and recognizes the impact of higher oil prices especially on poorer communities. In this context, the Committee calls for efforts to remove disincentives to investment in oil production and refining capacity, and to promote energy sustainability and efficiency, including through new technologies and removing barriers to the development of alternative fuels. It encourages closer dialogue between oil exporters and importers, and further efforts to improve oil market data and transparency.

The Committee is of the opinion that poverty reduction must remain at the top of the international agenda. It welcomes the strong growth performance across developing countries, particularly in sub- Saharan Africa, but notes with concern that most of them are at risk of falling well short of the Millennium Development Goals (MDGs). With improved macroeconomic stability in most countries, the key challenge remains to press ahead with reforms to strengthen the investment environment and foster private sector-led growth. The global community, in turn, needs to support these reform efforts through meeting commitments to increased and better coordinated financial and technical assistance, further debt relief, policies to improve remittance flows, and improved market access for developing countries.

The Committee encourages Doha participants to aim for ambitious and comprehensive results, notably in agriculture; substantial reductions in barriers to other trade, including liberalization in financial and other services; and strengthened multilateral trade rules. The Committee supports the IMF's continued role in advocating trade liberalization and assisting members to benefit from it. It encourages the IMF to work with other partners in the Integrated Framework to explore further ways of easing adjustment to trade liberalization, including through the Trade Integration Mechanism, and building capacity in low-income countries.

Underscoring the fact that IMF's lending function is a central pillar of its mandate, the Committee is of the opinion that all IMF's lending should be selective and anchored in strong country ownership and institutional frameworks, putting members firmly on the road to external viability. The Committee looks forward to further reflection on how the needs of members could be met through IMF arrangements, and whether new instruments or revisions to existing facilities are required.

The Committee underscores the conclusion of this year's Global Monitoring Report that bold actions are urgently needed by the developing countries and their partners to realize the MDGs. The Committee emphasized the critical role of IMF in supporting—through policy advice, capacity building, and financial assistance, including debt relief—low-income countries' efforts to achieve macroeconomic stability, debt sustainability, and strong, sustainable high growth needed to make progress toward the MDGs.

In this regard, work is underway to refine the operational aspects of the Poverty Reduction Strategy (PRS) approach, improve the design of PRGF-supported programs, and enhance

PRGF-PRS alignment. This will be underpinned by more extensive analyses of the sources of and obstacles to growth, and of the linkages between growth and poverty reduction. The Committee looks forward to further work to ensure adequate financing of the PRGF to meet future demands as assessed by the IMF, and other IMF instruments to assist low-income countries, including to help members deal with shocks. It also looks forward to further work on a policy monitoring arrangement to enhance the IMF's signaling role for countries that do not need or want IMF financing.

The Committee noted the recent progress in providing debt relief under the HIPC Initiative. It encourages countries to take the necessary actions to benefit from the Initiative, and urges full creditor participation. The Committee supports the joint IMF-World Bank framework to assist low-income countries' efforts to achieve and maintain debt sustainability while pursuing their development objectives, and a review of experience under the framework.

9.3.3 Meeting of the Development Committee

The Development Committee held its meeting at Washington, D.C. on April 17,2005. During the meeting, the Committee welcomed the actions undertaken both by developing and developed countries that contributed to the strongest global economic growth in over three decades. The Committee, however, noted that without tangible action to accelerate efforts, the vision of the Millennium Declaration will not be realized. Even though all regions face significant challenges, the Committee pointed out Sub-Saharan Africa as the region farthest from achieving the MDGs. The challenge facing Sub-Saharan Africa is to accelerate and sustain growth and development through sound policy frameworks. In this regard, the Committee welcomed the IFC's Strategic Initiative for Africa, including the recently approved Private Enterprise Partnership Facility.

The Committee also calls upon the World Bank to undertake further analytical and institutional work, together with partners, to develop an ambitious action plan for Africa for consideration for the next Committee meeting.

The Committee endorsed the emphasis on country-led and owned development strategies and urged that MDGs be operationalized in poverty reduction strategies, linked to medium term budgetary frameworks. Nevertheless, macroeconomic stability and environmental sustainability remains critical. It advised all countries to integrate climate concerns into their policy planning.

Identifying a major scaling up on education, health and basic infrastructure services as fundamental to meeting key development goals, the Committee noted with concern the failure to meet the target date for achieving gender parity in primary and secondary education. In this context, the Committee called upon bilateral donors and multilateral agencies to provide timely, predictable and sustained financing to support these efforts.

The Committee underlined the vital importance of an ambitious outcome for the Doha Development Agenda and the successful completion of the negotiations in 2006. Improving trade opportunities and market access for agriculture, industrial products and services is a critical issue.

The Committee welcomed the agreement by the Bank and Fund on a joint forward-looking framework for assessing debt sustainability in low-income countries, and the recent proposals for additional debt and debt service relief. A consensus was reached on the need of further debt relief beyond HIPC in specific cases to secure long-term debt sustainability and support progress towards the MDGs.
The Committee confirmed its commitment to deliver on the pledges made at and after Monterrey to raise levels of ODA to 0.7 percent of GNI and urged those donors that have not done so far to raise ODA to the target level. The Committee expressed its concern with retard to enhancing voice and participation of developing and transition countries in the Bank and the Fund. It suggested that the progress could

only be made through broad consensus at the political level.