Governor's Note

1. The Ethiopian economy recorded a strong growth of 8.8 percent in FY 2011/12 as a result of expansion in all sectors. The service sector expanded nearly by 10.6 percent while agriculture and industry sectors showed 5 and 17.1 percent growth rates, respectively. This robust economic growth has placed Ethiopia among the top performers in Africa and other developing Asian economies.

2. The economy has also continued to exhibit a gradual structural change towards service and industry sectors with declining share of the agriculture sector. Accordingly, the contribution of service sector to the economy rose to 53.7 percent while that of agriculture and industry was 24.2 percent and 22.2 percent, respectively. Yet, agriculture has remained the major player in terms of employment, source of foreign exchange, supply of raw materials as well as market for domestic industries.

3. Ethiopia had been a low inflation country for several years. In the past few years, however, it has experienced unprecedented high inflation. For instance, annual average inflation rose to 34.1 percent in 2011/12 compared to 18.1 percent a year ago due to a significant increase in the prices of food and non-food items during the year. Annual average food inflation surged by 42.9 percent compared to 15.7 percent in the preceding year as a result of price escalation in all food items except oil and fats, vegetables, spices and coffee. Similarly, annual average core inflation rose by 22.4 percent, slightly higher than 21.8 percent recorded in the previous year as the prices of all non-food components tended to increase.

4. Inflation, therefore, has become a serious concern for the country. Accordingly, a number of coordinated monetary and fiscal policies as well as other administrative measures have been taken to curb inflation, mitigate its effect on the poor as well as its disruptive role on savings, investment and employment. These policies have already born positive outcomes.

5. In relation to fiscal sector, the government pursued prudent fiscal policy and pro poor expenditure programs. It has also under taken measures to improve tax collection and tax administration system. Accordingly, general government revenue (including grants) surged by 35 percent in 2011/12 over the preceding year. Hence, the ratio of general government revenue to GDP slightly improved to 14 percent from 13.7 percent a year earlier. General government expenditure also increased by 32.6 percent during the same period. As a result, fiscal deficit as percentage of GDP in FY 2011/12 stood at 2 percent, which is sustainable.

6. Regarding the monetary sector, monetary policy continued to focus on maintaining price and exchange rate stability, ensuring financial system soundness and creating conducive environment for sustainable economic growth. To achieve these strategic objectives, the National Bank of Ethiopia (NBE) uses reserve money as monetary anchor to closely monitor monetary developments. Accordingly, reserve money showed a 4.4 percent decline as commercial banks' deposits at the NBE tended to plummet more rapidly than the rise in currency in circulation as well as a 28.4 percent drop in net foreign assets. Meanwhile, domestic liquidity as a measure of broad money supply (M2), increased by 30.3 percent mainly on account of a 39.5 percent expansion in domestic credit. Domestic credit to government, however, dropped by about 25 percent, while that to non-government sector rose sharply by 57 percent.

7. In the financial sector, significant results were achieved despite global economic and financial crisis. The performance of the Ethiopian banking sector in 2011/12 has been generally encouraging. The number of banks operating in the country rose to 17 and their branch network expanded to reach 1,289 from 970 recorded in the previous year. Thus, bank branch to population ratio declined to 62,000 from 82,000 a year ago. In addition, all banks registered high profit and increased their mobilization of resources, capital, loan disbursement etc. Deposit mobilized by the

banking system during the review fiscal year went up by 42.5 percent and new loan disbursements by 32.9 percent. In contrast, their excess reserves dropped significantly by 48.9 percent to Birr 3.7 billion from Birr 7.3 billion in the preceding fiscal year. Non-performing loans were also below the prudential requirement of 5 percent.

8. Meanwhile, the number of insurance companies increased to 15 and their branch network reached 243 of which 22 were opened in 2011/12 alone. Capital of the insurance companies also rose to Birr 1.2 billion from Birr 955.7 million in the previous fiscal year.

9. Similarly, microfinance institutions recorded impressive performance during the same period. Their total capital and total asset increased by 27.5 and 31 percent and reached Birr 3.8 billion and Birr 13.3 billion, respectively. They also mobilized 38 percent more deposits than last year and their clients have topped 2.8 million.

10. With regard to external sector, USD 3.15 billion was earned from merchandize export during 2011/12 showing a 14.8 percent annual growth. This growth was attributed to higher volume of exports and international prices of all major export items except coffee. Europe was the main destination for 47 percent of the total Ethiopian export followed by Asia (30 percent) and Africa (19 percent). Net service receipts, however, went down sharply by 89 percent mainly as a result of higher service payments (44.4 percent) outweighing moderate (8.7 percent) increase in total service receipts.

11. In the mean time, total merchandize import bills increased strongly by about 34 percent and reached USD 11 billion as a result of significant growths in imports of consumer goods (54 percent), fuel (28 percent), and semi-finished goods (59.4 percent) as well as capital goods and raw material inputs (8 percent). Asia was the main source of merchandise imports accounting for about 65 percent of Ethiopian imports, followed by Europe (23 percent) and Africa (5 percent).

12. Meanwhile, net private transfers showed a 9 percent growth while official transfers dropped marginally by 4 percent. Consequently, the current account (including official transfers) registered a deficit to the tune of 6.6 percent of GDP. The current account deficit was also the main source of the overall deficit of balance of payments. As a result, the international reserves of the country were adequate to finance 1.9 months of imports of goods and services of next year.

13. The average exchange rate of the Birr in the official market showed a 7 percent depreciation through 2011/12 to Birr 17.25/USD. The parallel market rate also reached Birr 17.98/USD. Consequently, the average premium between the official and parallel market rates widened to 4.3 percent from 2.6 percent last year, mainly due to a relatively faster depreciation of the Birr in the parallel market.

14. As for financial market developments, Treasury bills were the only securities traded in the primary market. The demand for T-bills increased by 38.4 percent and the sales rose by 43.7 percent to reach Birr 74.7 billion. The yield across maturities also tended to increase. At the same time, there has been no bond market except the sales of corporate bond to finance long term infrastructure development.

15. All in all, while the Ethiopian economy showed positive developments during 2011/12 it has also faced some major challenges. Inflation, low international commodity prices and current account deficit as well as limited international reserves were the major constraints that the country faced.

16. Looking ahead, the Ethiopian economy is anticipated to remain resilient in 2012/13, supported mainly by improved macroeconomic and weather conditions. The government is committed to bring inflation down to single digit level through enhanced tight monetary and prudent fiscal policies. International competitiveness is also expected to improve as a result of exchange rate stability and other export

enhancing strategies. Efforts will be made to build up international reserves of the country through higher exports, remittance inflows and FDI. Mobilization of domestic savings will also be enhanced using the available and new instruments.

17. Finally, I would like to thank the management and all staffs of the Bank, as well as all other stakeholders for their support and I call upon all of them once again to continue making their contribution to the Bank to enable it achieve its strategic objectives of maintaining price and exchange rate stability, ensuring sound financial system and contributing to economic growth as specified in the country's five year Growth and Transformation Plan.

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GOVERNOR