# Governor's Note

1. The Ethiopian economy continued its resilience in 2012/13 showing a strong growth of 9.7 percent, compared to 4.9 percent estimate for Sub-Saharan Africa. This strong economic expansion has placed Ethiopia among the fast growing African and other developing economies. Service sector expanded by 9.9 percent while agriculture and industry sectors registered 7.1 and 18.5 percent growth rates, respectively reflecting the fact that the economic growth in Ethiopia was broad based and undergoing structural changes.

2. Yet, agriculture continued to play a significant role in the Ethiopian economy in terms of employment, export earnings, source of raw materials and domestic market although its share slightly declined from 43.7 percent in 2011/12 to 42.6 percent in 2012/13. Meanwhile, the share of service sectors went up marginally from 44.8 percent to 45.0 percent and that of industry from 11.5 percent to 12.4 percent.

3. Inflation which had historically been low in Ethiopia for several years tended to pose a major challenge since 2008/09. In 2012/13 however, inflationary pressure began to ease as annual average headline inflation dropped to 13.5 percent compared to 34.1 percent a year earlier due to a 30.3 percent slowdown in food & non-alcoholic beverages and 7.6 percent drop in non-food inflation. Likewise, annual headline inflation has scaled down from 20.8 percent in 2011/12 to 7.4 percent in the review year on account of 21.7 and 4.0 percentage point declines in food and non-food annual inflation rates, respectively.

4. These significant achievements in harnessing inflationary pressure were made possible to a number of coordinated prudent monetary and fiscal policies as well as other administrative measures taken over the recent years.

5. As for fiscal sector, the government continued to pursue prudent fiscal policy and pro poor spending programs. Various measures have been taken to improve tax collection and tax administration systems. As a result, general government revenue (including grants) showed annual growth of 18.6 percent and reached Birr 137.2 billion in 2012/13. Therefore, the ratio of general government revenue to GDP

improved to 14.6 percent from 13.9 percent a year ago. Similarly, general government expenditure reached Birr 153.9 billion witnessing a 23.7 percent annual increase as recurrent expenditure rose by 22.0 percent and capital expenditure by 25.0 percent. Hence, fiscal operations resulted in Birr 16.7 billion deficit where its ratio to GDP was 2.0 percent compared to 1.3 percent a year earlier.

6. Monetary policy continued to focus on maintaining price & exchange rate stability, ensuring financial system soundness and creating favourable environment for economic growth. To achieve these strategic objectives, the National Bank of Ethiopia (NBE) adopted a monetary policy regime of using reserve money as a nominal anchor and implementing it in a rigorous manner. Accordingly, reserve money expanded by 13.6 percent largely due to a 19.9 percent growth in currency in circulation in contrast to 0.8 percent slow down in commercial banks' deposit at the NBE. Similarly, broad money supply ($M_2$) went up by 24.2 percent due to a 23.4 percent surge in domestic credit particularly to non government sector and 14.7 percent growth in net foreign assets.

7. Treasury bills remained the only securities traded in the primary market. In 2012/13, the demand for T-bills rose by 41.4 percent whereas the sales surged by 46.2 percent and totalled Birr 109.2 billion. The average yield across maturities slightly rose from 1.8 to 1.9 percent. Hence, T-bills have become one of the monetary policy instruments for mitigating inflationary pressure and as one of the sources of fiscal deficit financing. Besides T-bills, corporate bonds were also issued to finance largely public sponsored infrastructure developments.

8. Concerning external sector developments, FY 2012/13 exhibited mixed results. Total export amounted to USD 3.1 billion, showing a 2.5 percent drop against the previous fiscal year as a result of lower earnings from traditional exports such as coffee, gold, oilseeds, flower, live-animals, meat & meat products and fruits & vegetables. Net service receipts, however, surged sharply mainly owing to lower service payments (39.8 percent) and an increase in net receipt from transport services (69.3 percent).

9. On the other hand, total merchandize import rose by about 3.7 percent to USD 11.5 billion as imports of capital goods and fuel depicted 20.6 and 1.8 percent growth in connection with an ever increasing demand associated with the country's sustained economic growth. The value of imports of consumer goods, semi finished goods and raw materials however tended to decline. Hence, as the growth of imports outpaced sluggish export, the country's trade balance has widened.

10. Yet, net transfers improved by 7.7 percent on account of 7.5 percent increase in NGO transfers and 28 percent surge in private individual transfers despite 14.4 percent slowed down in net official transfers. As a result, the current account balance (including official transfers) recorded USD 2.5 billion in deficit slightly lower than last fiscal year. Similarly, the overall balance of payments deficit improved to USD 114.2 million from USD 972.8 million a year ago. The international reserve of the country was adequate to finance 1.7 months of imports of goods and non-factor services.

11. As for exchange rate developments, the Birr was stable in line with the country's managed float exchange rate regime. The value of Birr continued to be determined in the daily interbank foreign market whereby the NBE is also a player aiming at stabilizing the market. Accordingly, the average exchange rate of the Birr in the official market was allowed to depreciate by 5.5 percent to Birr 18.1947/USD. Similarly, the Birr depreciated by 7.7 percent in the parallel market and reached Birr 19.3022/USD. As a result, the average premium between the two exchange rates widened to 6.1 percent from 4.3 percent last year largely due to a moderately faster depreciation of the Birr in the parallel market rate. Meanwhile, since 2010/11, real effective exchange rate of the Birr has been appreciating owing to higher domestic inflation rate relative to trading partners' inflation. In 2012/13, however, it merely appreciated by 0.6 percent compared to 13.5 percent appreciation in 2011/12 as domestic inflation subsided. Hence Ethiopia's international competitiveness has slightly improved.

12. Ethiopia has also seen remarkable achievement with respect to financial sector developments. The number of banks operating in the country has reached 19 of which 16 were private and 3 public. Their branch network expanded to 1,724 from

1,289 a year ago as 435 new branches were opened during the fiscal year alone. Consequently, bank branch to population ratio improved to 49,826 from 62,063.6 a year earlier. Yet, Ethiopia remains as one of the under banked countries even at African standard, the fact which calls for further developing the financial sector in order to increase its outreach and play its vital role in economic development. Moreover, all banks have demonstrated encouraging results. They have increased their profit, resource mobilization, loan collection and capital build up. Their deposit mobilization saw a 26.6 percent annual growth while loan collection increased by 18.8 percent. They also extended new loans to the tune of Birr 54.3 billion of which about 63 percent went to the private sector. In terms of soundness indicators too, commercial banks are faring well in terms of capital adequacy, return on assets and non performing loans all of which are within the prudential requirements.

13. Insurance business has also seen rapid expansion since the opening of the sector to private investors. There were 16 insurance companies in 2012/13 of which 15 were private. Their branch network expanded to 275 from 194 in 2009 following the opening of 32 additional branches in 2012/13 alone. Consequently, population per insurance branch has slightly improved as one branch service about 309 thousand people in contrast to 396 thousand in 2009. Capital of the insurance companies also surged to Birr 1.5 billion from Birr 1.2 billion registered in the previous fiscal year showing a 25 percent annual growth. They have also been sound in terms of solvency, profitability and other soundness indicators.

14. Likewise, microfinance institutions are playing a remarkable role in contributing to poverty alleviation and asset creation. Their total capital has increased by 20.8 percent to Birr 4.5 billion and their assets grew by 33 percent to Birr 17.7 billion in 2012/13. They also mobilized Birr 7.61 billion in the form of saving which was 39.6 percent higher than last year. Their credit disbursement also increased by 37.6 percent to Birr 12.8 billion. They are well regulated and proven to have been sound.

15. In a nutshell, the Ethiopian economy continued in its fast growth trajectory during the review fiscal year despite some external and internal shocks. External shocks were largely associated with international commodity prices which led to un-favourable current account balance and limited international reserves while domestic factors included structural rigidities and supply side constraints which impacted on inflation expectations.

16. Looking forward, the Ethiopian economy is expected to record double digit growth in 2013/14 supported mainly by improved macroeconomic stability and weather conditions. Inflation will remain in single digit aided by continued tight monetary and prudent fiscal policies. International competitiveness is also envisaged to improve as a result of exchange rate stability and other export enhancing and import substituting strategies. Further efforts will also be exerted to increase the international reserves position of the country through higher exports, enhanced inward remittances and FDI inflows. Moreover, domestic savings mobilization will be enhanced using the available policy instruments and introducing new ones, as well as by expanding financial inclusion and outreach.

17. In conclusion, I am grateful to the management and all staffs of the Bank for their dedication and commitment to the realization of the Bank's strategic objectives as well as that of the country's Growth and Transformation Plan, and I urge all of them to double their efforts and commitments to achieve more results in the coming years.