**Governor’s Note**

1. Continued its buoyancy, the Ethiopian economy has registered a significant growth rate of 10.3 percent in 2013/14, which was about double growth compared to the 5.4 percent projection for Sub-Saharan Africa for the year 2014. This makes Ethiopia one of the fast growing economies not only in African but also at global level. Sector wise, agriculture which is the main stay of the economy grew by 5.4 percent while industry and services expanded by 21.2 and 11.9 percent respectively revealing the fact that the economic growth in Ethiopia has turned to become broad based.

2. The share of agriculture in GDP declined from 41.8 percent in 2012/13 to 39.9 percent in 2013/14 while that of industry rose from 12.9 percent to 14.2 percent and that of service sector from 45.3 percent to 45.9 percent. These sectoral ratios broadly reflect broad based economic growth as well as gradual economic transformation that has been taking place over the last decade.

3. The National Bank of Ethiopia’s multi-faceted monetary policy has continued to focus on maintaining price and exchange rate stability, ensuring financial system safety and soundness as well as creating conducive environment for economic growth. To accomplish these strategic objectives, the National Bank of Ethiopia (NBE) has pursued a monetary policy regime of using reserve money as a nominal anchor and implementing it in a prudent way. In view of that, reserve money expanded by 18.7 percent on account of 17.2 percent growth in currency in circulation and 22.9 percent surge in commercial banks’ deposit at the NBE. Hence, broad money supply (M₂) has scaled up by 26.5 percent as a result of 28.4 percent expansion in domestic credit and a modest 0.9 percent increase in net foreign assets.

4. Regarding fiscal sector, prudent fiscal policy and pro-poor spending programs have been instrumental in sustaining macroeconomic stability and growth as well as in reducing poverty. As a result of the different fiscal measures undertaken, general government revenue mobilization (including grants) reached Birr 152 billion depicting a 15.2 percent increase over the preceding fiscal year. Yet, the ratio of general government revenue to GDP slightly declined to 14.0 percent from 14.6 percent in 2012/13 signifying the need for enhancing tax efforts to mobilize more
domestic resources to meet demands of growing economy. At the same time, general government expenditure stood at Birr 185.5 billion witnessing a 20.5 percent annual growth. Specifically, recurrent expenditure scaled up by 24.4 percent and capital expenditure increased by 17.8 percent during the review fiscal year. Consequently, general government expenditure to GDP ratio slightly dropped from 18.1 percent in 2012/13 to 17.7 percent in the review fiscal year. All in all, the general government fiscal operations resulted in Birr 27.4 billion deficit which was larger than a year earlier. Yet the fiscal deficit as a ratio of GDP was 3.2 percent, which still reflected prudent fiscal stance of the country.

5. As a result of prudent monetary and fiscal policies as well as other administrative measures, annual average headline inflation plummeted significantly to 8.1 percent by end June 2014 compared to 13.5 percent a year ago thereby ensuring the successful achievements of single digit inflation objective of the county. This slowdown in inflationary pressure was attributed to a 6.7 percentage point drop in food & non-alcoholic beverages and 3.9 percentage point decline in non-food inflation. On the other hand, annual headline inflation slightly increased from 7.4 percent last year to 8.5 percent in the review fiscal year due to 2.6 percentage point rise in food & non-alcoholic beverages inflation offsetting a 0.9 percentage point decline in non-food inflation.

6. Treasury bills have remained the only securities traded in the primary financial market. In 2013/14, the demand for T-bills rose by 4.0 percent while sales declined by 12.7 percent to Birr 95.3 billion. The average yield across maturities scaled down from 1.9 to 1.6 percent during the review period. Besides T-bills, corporate bonds were issued by some public institutions to finance their infrastructure development projects. Inter-bank money market remained dormant during the FY 2013/14 as all banks had excess reserves.

7. With regard to external sector developments, the fiscal year 2013/14 witnessed a 5.6 percent growth in total merchandise exports which stood at USD 3.3 billion. This modest increase in merchandise export earnings was ascribed to higher earnings from export of all major items such as oil seeds, pulses, leather and leather products, fruits and vegetables and others. Earnings from coffee which has been the dominant traditional export commodity for decades, however, slowed down by
14.2 percent due to a 4.7 percent decline in export volume which offset a slight (0.5 percent) improvement in international coffee price. Accordingly, the share of coffee in total exports have steadily declined due to continuous efforts being made to diversify Ethiopia’s export base. In a nutshell, export revenue as percentage of GDP was about 7.3 percent in the review FY year compared to 7.5 a year earlier, which is a moderate improvement.

8. On the other hand, net service receipts surged by 21.9 percent mainly owing to 35.6 percent growth in interest income, 6.1 percent increase in net receipts from transport services and 45.3 percent hike in net government receipts.

9. In the meantime, total merchandize import reached USD 13.7 billion, showing a 19.7 percent annual growth as imports of capital goods, semi-finished goods, raw materials, fuel and consumer goods tended to increase during the review year. Hence, the share of imports in GDP reached 30.2 percent in contrast with 28.0 percent last year. The growth in imports clearly reflects an ever-expanding domestic demand associated with the country’s booming economy. This can readily be explained by an increase in capital goods import on account of huge investment in infrastructure like power, roads, railway, communication as well as industrial expansion such as sugar and textile factories. Yet, as a result of faster growth in inputs vis-à-vis export expansion, the trade deficit widened during the review fiscal year delineating the need for steady diversification of the country’s export regime and enhancing import substitution where ever feasible.

10. Net transfers also slightly improved by 1.9 percent owing to 19.3 percent growth in net private individual transfers and 13.0 percent increase in private transfers. Net official transfers, however, dropped by 24.1 percent and net NGO transfers by 5.8 percent due to absence in food receipts and a decline in cash receipts by 4.5 percent. Hence, the current account (including official transfers) recorded USD 4.7 billion in deficit remarkably higher than last fiscal year. Similarly, the deficit in overall balance of payments widened to USD 91.4 million from USD 6.5 million in 2012/13 reflecting an expanded trade deficit and adverse current account balance. In a nutshell, the international reserve of the country was adequate to finance 2.3
months of imports of goods and non-factor services, which was higher than 1.7 months of import cover in 2012/13.

11. Concerning Ethiopia’s exchange rate development, the Birr continued to remain stable in accordance with the country’s managed float exchange rate regime. Thus, the average exchange rate of the Birr in the official market showed 4.8 percent annual depreciation to reach Birr 19.0748/USD. Likewise, the Birr lost ground by 2.9 percent in the parallel market and stood at Birr 19.8666/USD. As a result, the average premium between the two rates narrowed to 4.2 percent from 6.1 percent last year, largely due to a relatively slow depreciation of the Birr in the parallel market. Similarly, owing to higher domestic inflation rate relative to that of trading partners’ inflation, the magnitude of real effective exchange rate of the Birr which has been appreciating since 2010/11 steadily declined in 2013/14 to show a modest appreciation of 0.4 percent compared to 0.6 percent a year earlier. Therefore, Ethiopia’s international competitiveness is believed to have slightly improved.

12. With respect to financial sector development and access to finance, Ethiopia has made a significant stride in this regard during 2013/14. The branch net work of the 19 commercial banks operating in Ethiopia expanded as 480 new branches were opened in a single year thereby improving bank branch to population ratio by about 20 percent. They have also increased their resource mobilization, loan collection and credit allocation. Their deposit mobilization showed a 7.0 percent annual growth to reach Birr 292.8 billion while loan collection increased by 23.7 percent reflecting the banks’ loan collection capacity and growing loan repayment culture of the public and private firms. At the same time, commercial banks (including Development Bank of Ethiopia) granted fresh loans to the tune of Birr 59.9 billion of which about 61.4 percent went to finance private sector operations

13. In terms of soundness and safety indicators, commercial banks continued to remain resilient. Their return on equity and assets were well above the required level and their non-performing loans were within prudential requirement. Therefore, banks were adequately capitalized, well regulated and highly profitable. With a view to improving access to finance and modernizing their financial intermediation, commercial banks have introduced a new mix of products
including mobile and agent banking, interest free banking, internet banking, ATMs and other card instruments. Virtually all banks have introduced core banking and effectively using the Ethiopian Automated Transfer System (EATS) as facilitated by National Bank of Ethiopia.

14. Similarly, insurance business has witnessed rapid expansion since the opening of the sector to the private investor two decades ago. By 2013/14, 17 insurance companies have been operating in the country. With 59 additional branches opened in 2013/14, the total insurance branch net work expanded to 332 from 273 a year earlier. They are also gradually increasing their service outreach. Their capital has shown 33.3 percent annual growth. All prudential indicators confirm that the sector is sound and profitable and it has a great potential to expand its market share in the country.

15. Micro finance institutions are one of the major operators in the Ethiopian financial sector. The number of micro finance institutions has reached 31 by 2013/14 and they are significantly contributing to poverty reduction and wealth creation both in rural and urban areas. Their total capital has increased by 24.6 percent to Birr 5.7 billion while their assets grew by 38.6 percent to Birr 24.5 billion. These micro finance institutions have mobilized Birr 11.8 billion in the form of savings which surged by 54.8 percent over last fiscal year. Their outstanding credit also hiked by 31.9 percent to reach Birr 16.9 billion by end June 2014.

16. To sum up, the Ethiopian economy remained resilient showing double digit growth during 2013/14. Inflation was kept in single digit as per the strategic objective set in the Growth and Transformation Plan (GTP). The Birr continued to maintain its stability with a 5 percent annual nominal depreciation. Ethiopia’s external competitiveness also tended to improve as domestic inflation was subdued relative to partner countries currencies. During 2013/14, external challenges were mainly associated with international commodity prices which had adverse effect on the country’s current account balance. Domestic factors included structural rigidities and supply side constraints, among others.

17. Looking ahead, the Ethiopian economy is expected to register double digit growth in 2014/15, supported mainly by improved macroeconomic stability, favourable
weather conditions and investment friendly economic policies. Inflation is envisaged to remain in single digit assisted by prudent monetary and fiscal policies. The country’s international competitiveness is presumed to improve on account of exchange rate stability and other export enhancing strategies and favourable capital account balance. Furthermore, the international reserve position of the country is expected to increase through higher exports, growing inward remittances and expanding FDI inflows. In addition, domestic resource mobilization will be enhanced through well regulated and supervised financial sector operation improved tax collection and administration.

18. Finally, I would like to thank all management and staffs of the Bank for their commitment and hard work to realize the Bank’s strategic objectives as well as the country’s five year Growth and Transformation Plan during the fiscal year. I also take this opportunity to urge all employees of the Bank to rally their hearts and minds towards achieving more tangible results during 2014/15 which will be the last year of GTP I.