IX. INTERNATIONAL DEVELOPMENTS

9.1 International Economic Developments[1]

9.1.1 Overview of World Economy

Global GDP measured at purchasing-power-parity weights is estimated to have increased by 4.9 percent in 2007—well above trend for the fourth consecutive year. Following a stronger-than-expected third quarter, activity in the advanced economies decelerated quite sharply toward the end of the year, particularly in the United States, as the debacle in the U.S. sub-prime mortgage market had knock-on effects across a broad range of financial markets and institutions.

By contrast, the emerging and developing economies continued to grow robustly, notwithstanding some slowing in activity toward the end of the year. China and India—which grew 11.4 percent and 9.2 percent, respectively, in 2007—continued to lead the way, but all regions maintained robust rates of growth. The growth momentum is being provided by strong productivity gains as these countries progressively integrate into the global economy, by terms-of trade increases for commodity producers as oil and other raw material prices continue to soar, and by strengthened policy frameworks.

The U.S. economy slowed markedly to grow by 2 percent in 2007, down from almost 3 percent in 2006. The pace of activity weakened sharply in the fourth quarter to only 0.6 percent (at an annualized rate). With the housing correction continuing full blast, the contraction of residential investment sliced a full percentage point off growth in 2007. Consumption and business investment also softened markedly toward the end of the year, as sentiment soured and lending conditions tightened significantly after the outbreak of financial turbulence in August, despite the Federal Reserve's aggressive turn to monetary easing.

For most of 2007, activity in Western Europe continued to expand at a robust pace. The euro area grew by 2.6 percent in 2007 as a whole, close to the

[1] Excerpts from IMF, World Economic Outlook, April 2008

rapid pace achieved in 2006 and still well above potential. Similarly, growth in the United Kingdom registered a strong 3.1 percent increase despite woes in the banking sector. Robust domestic demand was fueled by steady employment growth and buoyant investment, supported by healthy corporate balance sheets and strong global demand.

According to preliminary data GDP grew at an annualized rate of 3.5 percent in Japan in the fourth quarter of 2007, led by robust net exports and business investment. Exports continued to be supported by strong demand from Asia and Europe, and business investment rebounded after contracting during the first half of the year.

Following the tightening of building standards in June, the slump in residential investment continued and household spending remained weak. The growth momentum entering 2008, however, appears to have slowed with deteriorating business and consumer confidence, and export growth shows signs of moderating.

Table 9.1: Overview of World Economic Outlook and Projections

(Annual Percentage Changes)

	2006	2007	Projection 2008	Projection 2009
World Output	**5.1**	**5.0**	**3.9**	**3.0**
Advanced Economies	3.0	2.6	1.5	0.5
United States	2.8	2.0	1.6	0.1
Euro Area	2.8	2.6	1.3	0.2
Japan	2.4	2.1	0.7	0.5
Other Emerging Markets and Developing Countries	7.9	8.0	6.9	6.1
World Trade Volume (goods & services)	**9.3**	**7.2**	**4.9**	**4.1**
Imports				
Advanced Economies	7.5	4.5	1.9	1.1
Other Emerging Markets and Developing Countries	14.7	14.2	11.7	10.5
Exports				
Advanced Economies	8.4	5.9	4.3	2.5
Other Emerging Markets and Developing Countries	11.0	9.5	6.3	7.4
Commodity Prices				
Oil	20.5	10.7	50.8	-6.3
Non-oil	23.2	14.1	13.3	-6.2
Consumer Prices				
Advanced Economies	2.4	2.2	3.6	2.0
Other Emerging Markets and Developing Countries	5.4	6.4	9.4	7.8

Source: IMF, World Economic Outlook, October 2008

Growth in emerging Asia remained strong in the second half of 2007, although with some emerging signs of softness. Growth was led by China, where output expanded by 11.4 percent (year over year) in the second half of 2007, driven by strong investment growth and net exports, although the pace of growth moderated somewhat toward the end of the year. Growth in India slowed modestly to 8½ percent (year over year) in the second half of last year as consumption cooled in response to tighter monetary policy, although investment continued at a brisk pace. Robust domestic demand, led by consumption, supported activity in Indonesia, Malaysia, Hong Kong SAR, the Philippines, and Singapore, even while export growth began to show some signs of moderation. Export growth remained strong in Korea and Thailand, but high fuel prices and political uncertainty weighed on domestic demand in Thailand. In Korea, domestic demand was supported by an acceleration in construction and investment activity.

Building on the best period of sustained economic growth since independence, the pace of economic activity in sub-Saharan Africa (SSA) accelerated to 6.8 percent in 2007, led by very strong growth in oil-exporting countries and supported by robust expansions in the region's other economies. The region's strongest growth was recorded by Angola, where oil and diamond production have both risen sharply. In Nigeria, robust non-oil sector growth offset the drag from a decline in oil production in the Niger Delta. The pace of activity elsewhere in SSA has been supported by domestic demand (investment in particular), the payoff from improvements in macroeconomic stability, and the reforms undertaken in most countries. In South Africa, the region's largest economy, the pace of activity has eased modestly as tighter monetary policy, aimed at containing rising inflation pressures from food and fuel prices, has applied a brake to household spending, but investment continues to grow at a brisk pace in preparation for the 2010 FIFA World Cup.

9.1.2 World Trade

Growth in the volume of world trade in goods and services slowed down to 7.2 percent in 2007 from 9.3 percent in 2006. It is expected to further decline by 4.9 percent in 2008 and 4.1 percent in 2009. The growth in imports of the advanced countries, which was 7.4 percent in 2006 went down to 4.2 percent in 2007 and is further expected to fall to 3.1 percent in 2008. Similarly, the growth in exports of these countries declined to 5.8 percent in 2007 from 8.2 percent in 2006. Other emerging markets and developing countries' exports grew by 8.9 percent in 2007 compared to 11 percent in 2006 while growth in their volume of imports declined to 12.8 percent from 14.4 percent in 2006. Growth in exports of these countries is expected to further slow down to 7.1 percent in 2008 while their import growth is also expected to decline to 11.8 percent.

Although it showed some signs of narrowing down, global trade imbalance remained large in 2007. The US current account deficit declined to 5.5 percent of GDP in 2007 from 6.2 percent in 2006 mainly owing to depreciation of the US dollar and a more balanced pattern of global demand growth. On the other hand, China's current account surplus widened from 9.4 percent of GDP in 2006 to 11.1 percent in 2007.

9.1.3 Inflation and Commodity Prices

Headline inflation has increased around the world, boosted by the continuing buoyancy of food and energy prices. Rapid increases in commodity prices have mainly reflected continued strong demand growth in the emerging economies, which have accounted for the bulk of the increase in commodity consumption in recent years, and a sluggish supply response, with financial factors also playing some role. In the advanced economies, core inflation has edged upward in recent months despite slowing growth. In the emerging economies, headline inflation has risen more markedly, reflecting both strong demand growth and the greater weight of energy and particularly food in consumption baskets.

In the US rising oil prices helped dampen consumption, while also boosting 12-month headline inflation to 3.4 percent in February (measured using the personal consumption expenditure deflator). Core inflation has stood at about 2 percent, the top of the Federal Reserve's implicit comfort zone.

Rising food and fuel prices contributed to positive headline inflation in Japan in the last three months of 2007, but consumer price inflation, excluding food and energy, remained marginally negative.

Headline inflation in the euro area rose to 3.5 percent (year over year) in March 2008, considerably exceeding the European Central Bank's (ECB's) inflation threshold of 2 percent. The surge was largely in energy and food prices, which have risen sharply since mid 2007. Core inflation remained stable throughout 2007 at just under 2 percent, against a background of moderate wage increases and the dampening effect of euro appreciation, but it picked up in early 2008.

In the United Kingdom, inflation is projected to rise moderately from 2.0 percent in December 2007 to 2.5 percent in 2008 because of high energy and food prices. Although core inflation began to decelerate in the second half of 2007, inflation expectations have increased recently despite a weakening of the growth momentum.

The strength of domestic demand in emerging Asia, combined with rising food and energy prices, has contributed to a buildup of inflation pressures in a number of countries. In China, inflation rose to 8.7 percent in February. Inflation largely reflects rising food prices, boosted by a swine epidemic, but there is rising concern that persistent food price increases could spill over into wages and spark a broader pickup in inflation. Inflation pressures have also begun to emerge in Indonesia, Thailand, and the Philippines. In India, monetary tightening earlier in the year led to an easing of inflation by the end of 2007; however, inflation started to pick up in 2008 owing to rising commodity prices.

In Sub-Saharan Africa, inflation pressures remain generally well contained, reflecting a variety of factors, including stabilization gains in some countries, improved food supplies, appropriately restrictive monetary policies— with, in some cases, exchange rate appreciation in response to capital inflows—and lower bank financing of fiscal deficits.

The commodity price boom picked up in 2007 and has shown little sign of abating in 2008, notwithstanding financial market turmoil and concerns about slowing growth in the major advanced economies. The IMF commodity price index rose by 33 percent during the first six months of 2008, led by soaring fuel prices, before softening in the third quarter of the year. Many prices—including those of crude oil, tin, nickel, soybeans, corn, and wheat—reached new record highs in current U.S. dollar terms.

After rising rapidly in the first half of 2007, oil prices experienced another strong run-up from late August to early January 2008. Over the year, spot prices for West Texas Intermediate (WTI) rose from $58 a barrel on January 3, 2007, to more than $100 a barrel on January 2, 2008. Although prices eased thereafter around concerns about slowing global growth, prices recovered in February and have stayed above $100 a barrel since end-February on a string of news signalling short-term supply problems and financial factors, as discussed above. Oil prices reached an all-time record high (in both nominal and real terms) of $143 a barrel on July 11, and then declined to just over $100 by mid-September.

With the moderate easing of market conditions— at least through end-2009—but with inventories and spare capacity still low, oil prices are expected to remain high, albeit below recent peaks. Oil futures options prices suggest a much wider range of uncertainty about price prospects than in recent years. Oil prices are expected to range between $60 a barrel to more than $165 a barrel for end-2008.

Food prices rose by 39 percent from February 2007 to February 2008—led by wheat, soybeans, corn, and edible oils, all of which reached new highs. As in the oil market, price strength reflects tight market balances, with inventories of major food crops at a two-decade low despite generally robust production growth. The tightening reflects a number of factors. Rising biofuel production in the United States and the European Union has boosted demand for corn, rapeseed oil, and other grains and edible oils. Although biofuels still account for only 1½ percent of the global liquid fuels supply, they accounted for almost half the increase in the consumption of major food crops in 2006–07, mostly because of corn-based ethanol produced in the United States.

9.1.4 Exchange Rates

The US dollar remained weak against major currencies in 2007/08. The average exchange rate of the US dollar against the Euro which was 1.37 in July 2007 depreciated to 1.56 in June 2008. Similarly, the dollar also depreciated against the Japanese yen from 121.4 to 107 over the same period. On the other hand, the dollar gained some ground against the Pound Sterling in the first half of 2008 after falling to record lows for most of the second half of 2007. The average dollar-pound exchange rate which was 2.04 in July 2007 dropped to 1.97 in June 2008.

The Chinese reminibi continued its gradual but steady appreciation against the US dollar. The average exchange rate of the reminibi against the dollar which was 7.58 in July 2007 appreciated to 6.9 in June 2008.

9.1.5 Capital Flows

In 2007, there was a big surge in net capital inflows to emerging and developing countries which jumped to USD 492 billion from USD 65 billion in 2006. This surge was in the form of increased private direct investment inflow (from USD 246 billion in 2006 to USD 379 billion), net private portfolio flows and higher other private capital flows which rose from USD 84 billion to USD 200 billion. Net capital inflows are expected to slightly drop to USD 370 billion in 2008 mainly as a result of outflows in private capital inflows and decline in the net flow of other private capital despite an expected increase in private direct investment flows.

Net capital flows to African countries doubled to USD 38 billion in 2007 from USD 19 billion in 2006 as a result of higher inflow of private direct investment decline in official capital outflows. Private direct investment to Africa amounted to USD 31 billion in 2007 which accounted for a mere 8 percent of the total private direct investment inflows to emerging and developing countries. Net capital inflows to African countries are expected to further rise to USD 50 billion in 2008.

9.2 Implications of International Economic Development on Ethiopian Economy

The hike in the price of oil in the international market remained the major threat to the Ethiopian economy in 2007/08. The country's oil import bill accounted for about 24 percent of total imports contributing to the very rapid growth of imports, which in turn was the major factor for the widening of the current account deficit.

The global price increase was also one of the factors that was pushing domestic prices higher to unprecedented levels during the fiscal year.

The global financial crisis which started in August 2007 and intensified during September 2008 is also bound to affect the Ethiopian economy, albeit minimally. As the crisis is pushing advanced economies towards recession, commodity prices are likely to go down. And the decline in commodity prices, including coffee, oilseeds etc. is bound to reduce the country's export earnings.

In addition, as the governments in the advanced economies will be preoccupied in dealing with the crisis as well as spend a huge sum of money for the cause, there is a risk that official development assistance may decline. Moreover, the slow down in these economies may also lead to a drop in remittance and FDI inflows.