

IX. INTERNATIONAL ECONOMIC DEVELOPMENTS

9.1 Overview of World Economy¹

Though the U.S. economy has slowed in early 2007, spillovers over other economies have been limited. Growth around the world looks well sustained, and inflation risks have been moderated. Global growth is expected to moderate to 4.9 percent in 2007.²

The overall growth in U.S. economy is sustaining despite the sharp downturn in the housing sector. Investment has slightly slowed, but consumption remained adequate supported by a strong labor market and healthy household balance sheets. However, growth in US economy in 2007 is expected to come down to 2.2 percent from 3.3 percent in 2006.

The Euro area is experiencing its fastest growth in six years. However, growth is expected to ease reflecting the slightly

contractionary monetary and fiscal policies and the appreciation of the Euro against USD. Exports and investment were the key driving forces, but consumption expenditure, which had been a major drag to growth in the past, is also expected to contribute significantly.

Japan's economic expansion has momentum, and the growth is projected to continue at about the same pace as in 2006 (2.2 percent). Solid corporate profits underpin investment, while improved conditions in the labour market which are expected to strengthen consumer confidence and household consumption and the external sector are the driving forces for the expected growth.

Available information also shows that emerging markets and developing countries, led by China and India, continue to enjoy remarkable growth.

¹ The figures in this section are obtained from IMF, April 2007 World Economic Outlook and UN report on World Economic Situation and Prospects 2007, update as of mid 2007.

² IMF, April 2007, World Economic Outlook

These economies will continue to draw support from favorable global financial conditions and commodity prices that remain high. China's growth is expected to remain rapid in 2007, albeit a little below the pace in 2006, while India's economy continue to grow rapidly.

Growth in Africa is expected to remain robust at a pace of about 6 per cent during 2007. Rising mining and hydrocarbon production and increased public spending, especially on infrastructure are expected to bolster the growth. In comparison, growth in the oil-importing countries of the region is less robust on average, with a few exceptions. Meanwhile, political and social tensions have still constrained economic growth in a number of African economies.

Overall, the global economy has achieved a fast pace of sustained growth in the last five years. The annual growth in global economy is expected to moderate to 4.9 percent in 2007, 0.5 percentage point slower than in 2006.

9.2 Exchange Rates

In foreign exchange markets, the U.S. dollar has weakened in 2006 and early 2007, mainly against the Euro and Pound Sterling. The Yen has also depreciated further, in part because prospects for continued low interest rates have encouraged capital outflows, although it slightly recovered in early 2007.

Pound Sterling's appreciation in the first quarter of 2007 was strong against all major currencies while Euro slightly appreciated against all major currencies except Pound Sterling. The Chinese Renminbi has declined modestly in real effective terms despite a mild acceleration in its rate of appreciation against the dollar.³

9.3 Inflation and Commodity Prices

Inflation (as measured by the consumer price index) in the United States has been above 3 per cent for two years in a row as the unit labour costs have risen

³ IMF, April 2007, World Economic Outlook

gradually. However, it decelerated in the first quarter of 2007 and the annual inflation is expected to reach 2 percent in 2007.

In the Euro area, consumer price index registered 2.2 per cent growth in 2006, above the upper bound of the European Central Bank target of “less than 2 per cent”. Headline inflation is expected to remain close to 2 percent, but to fall slightly in 2007. In Japan, a continued recovery in domestic demand has finally pushed the economy out of its deflationary spiral and inflation indicators are expected to be above zero in 2007.

Commodity price developments have been dominated by a further surge in metals prices and sharp movements in oil prices. Oil prices rose sharply in the first part of 2006, reaching a record nominal high in August, but then dropped significantly, showing only a moderate rise for the year as a whole. After a short-lived dip at the beginning of 2007, prices recovered and rose sharply at end-March as a result of renewed geopolitical tensions in the Middle East.

In the first three months of 2007, metals prices fluctuated, but generally remained strong, while agricultural prices continued to rise, albeit at a slower pace.

In the remaining months of 2007, the strength of food and metal prices are expected to sustain.

9.4 Impact of the Global Economic Development on the Ethiopian Economy

The expansion in global economy and improvement in agricultural commodity prices have supported Ethiopia’s export both in volume and prices.

The unit value of almost all Ethiopia’s major export items has increased in the third quarter of 2006/07. Compared with the previous quarter, the highest increase in international prices was observed in fruits and vegetables (21.5 percent), pulses (18.4 percent) and coffee (17.7 percent).

On the other hand, the rise in commodity prices in the global market has affected the country by raising the cost of imported goods which resulted in reserve drawdown. Particularly, oil prices, though below their August 2006 peaks, are still posing concerns. The share of fuel import from total import in the third quarter has risen to 17.1 percent from its level of 16.5 and 10.2 percent in the previous quarter and the same period of last year. However, the impact of the oil price has been partially absorbed by government subsidy in order to minimize its impact on the poor.

The depreciation of USD against major currencies has improved the competitiveness of Ethiopia's export. However, high domestic inflation has more than offset this gain as the real effective exchange rate appreciated by 1.7 percent in the third quarter over the preceding quarter. The continued depreciation of the Birr against Pound Sterling and Euro may attract Ethiopia's trade flows towards these currency areas.

