VI. FEDERAL GOVERNMENT FINANCE

Overall fiscal balance (including grants) of the Federal Government depicted a deficit of Birr 1767.1 million during the third quarter of 2006/07. This figure was higher by more than threefold compared to Birr 475.2 million deficit in the preceding quarter, but 3.3 percent lower than the deficit in the same period of last fiscal year, which was Birr 1827.1 million.

In the review quarter, total revenue and grants fell to Birr 4369.7 million from Birr 6223.3 million in the preceding quarter. Year on year basis, however, total revenue and grants went up by 26.6 percent.

Meanwhile, quarterly Federal Government expenditure stood at Birr 6.1 billion exhibiting 8.4 percent decline over the previous quarter and 16.3 percent increase vis-à-vis the same period of last fiscal year.

Table VI.1 Summary of Federal Government Finance

(In million Birr)

No	Particulars	2005/06	2006/07			Percentage Change		Performa-nce Rate
		Qtr. III	Budget	Qtr. II	Qtr. III			
		[A]	[B]	[C]	[D]	[D/A]	[D/C]	[D/B]
1	**Revenue and Grants (1.1+1.2)**	**3451.1**	**24551**	**6223.3**	**4369.7**	**26.6**	**-29.8**	**17.8**
1.1	**Total Revenue**	**3366.4**	**18994**	**5432**	**3573.4**	**6.1**	**-34.2**	**18.8**
	Tax Revenue	2765.2	14646	3666.5	3199.0	15.7	-12.8	21.8
	Non-Tax Revenue	601.2	4348	1765.5	374.5	-37.7	-78.8	8.6
1.2	**PBS Grant & Relief**	**84.7**	**5557**	**791.3**	**796.3**	**840.1**	**0.6**	**14.3**
2	**Current Expenditure**	**1638.5**	**8282**	**1396.6**	**1882.7**	**14.9**	**34.8**	**22.7**
3	**Current Surplus/Deficit (1.1-2)**	**1727.9**	**10712**	**4035.4**	**1690.7**	**-2.2**	**-58.1**	**15.8**
4	**Capital Expenditure[2]**	**2062.1**	**12557**	**2526**	**2089.1**	**1.3**	**-17.3**	**16.6**
5	**Regional Transfers**	**1562.6**	**9056**	**2759.4**	**2157**	**38.0**	**-21.8**	**23.8**
6	**Special Program**	**15**	**0**	**16.5**	**8**	**-46.7**	**-51.5**	
7	**Total Expenditure[1] (2+4+5+6)**	**5278.2**	**29895**	**6698.5**	**6136.8**	**16.3**	**-8.4**	**20.5**
8	**Overall Surplus/Deficit**							
	(Including Grants) (1-7)	-1827.1	-5344	-475.2	-1767.1	-3.3	271.9	33.1
	(Excluding Grants) (1.1-7)	-1911.8	-10901	-1266.5	-2563.4	34.1	102.4	23.5
9	**Total Financing**	**1827.1**	**5344**	**475.2**	**1767.1**	**-3.3**	**271.9**	**33.1**
9.1	**Net External Borrowing**	**325.6**	**1348**	**182.8**	**-540.7**	**-266.1**	**-395.8**	**-40.1**
	External Borrowing	470.9	2308	291.9	-317.9	-167.5	-208.9	-13.8
	Special program	33.7	0	72.5	66	95.8	-9.0	
	Amortization Paid	-263.6	960	181.6	288.7	-209.5	59.0	30.1
9.2	**Net Domestic Borrowing**	**-581.6**	**3996**	**-1941.8**	**1641.9**	**-382.3**	**-184.6**	**41.1**
	Banking System	-603.6	3996	-2277.6	1298.4	-315.1	-157.0	32.5
	Non-Bank Sources	22	0	335.8	343.5	1461.4	2.3	
9.3	**Privatization Receipts**	**0**	**0**	**0**	**0**			
9.4	**Others and Residual**	**2167.7**	**0**	**2234.2**	**666**	**-69.3**	**-70.2**	

Source: Ministry of Finance and Economic Development

6.1 Revenue and Grants

Of the total Birr 4.37 billion revenue and grants mobilized during the third quarter of 2006/07, 73.2 percent was from tax, 8.6 percent from non-tax and the remaining 18.2 percent from CPF grant. The amount of grant and relief for Protection of Basic Services (PBS) during the quarter under review was slightly higher than that of the preceding quarter.

Table VI. 2 Summary of Federal Government Revenue by Component

(In Millions Of Birr)

Particulars	2005/06 Qtr.III [A]	2006/07 Budget [B]	2006/07 Qtr.II [C]	2006/07 Qtr.III [D]	Percentage Change [D/A]	Percentage Change [D/C]	Performance Rate [D/B]
Total Revenue and Grants	**3366.4**	**24550.0**	**6223.3**	**4369.6**	**29.8**	**-29.8**	**17.8**
Total Domestic Revenue	**3366.4**	**18993.0**	**5432.0**	**3573.3**	**6.1**	**-34.2**	**18.8**
1 Tax Revenue	**2765.2**	**14645.0**	**3666.4**	**3198.8**	**15.7**	**-12.8**	**21.8**
1.1 Direct Tax Revenue	**362**	**2857**	**1084.9**	**415.3**	**14.7**	**-61.7**	**14.5**
1.1.1Income Taxes	199.3	2264	943.8	261.4	31.1	-72.3	11.5
- Personal	142.1	598	128.04	145.77	2.6	13.8	24.4
- Business	57.2	1666	815.8	115.58	102.1	-85.8	6.9
1.1.2 Others[1]	162.7	593	141.06	696.51	328.1	393.8	117.5
1.2. Indirect Taxes	**2403.2**	**11788**	**2581.5**	**2783.5**	**15.8**	**7.8**	**23.6**
2. 2.1 Domestic Taxes	589.1	3551	719.92	819.29	39.1	13.8	23.1
2. 2.2 Foreign Trade Taxes	1814.1	8237	1861.6	1964.16	8.3	5.5	23.8
- Import	1814.1	8237	1861.6	1964.16	8.3	5.5	23.8
2. Non-Tax Revenue	**601.2**	**4348**	**1765.5**	**374.5**	**-37.7**	**-78.8**	**8.6**
O/W Dividend	239	1500	1000.33	186.04	-22.2	-81.4	12.4
3. PBS Grants and Relief	**84.7**	**5557**	**791.3**	**796.3**	**840.1**	**0.6**	**14.3**

Source: Ministry of Finance and Economic Development

1/'*Others*' include rental, withholding tax and interest income

As it can be seen from Figure VI.1, a clear trend of seasonality in domestic government revenue has emerged since 2004/05. The seasonality originated particularly from non-tax revenue. Non- tax revenue was uniformly low at the first and third quarters and high at the second and fourth quarters of a fiscal year.

Fig. VI.1 Quarterly Developments in Major Components of Domestic Revenue

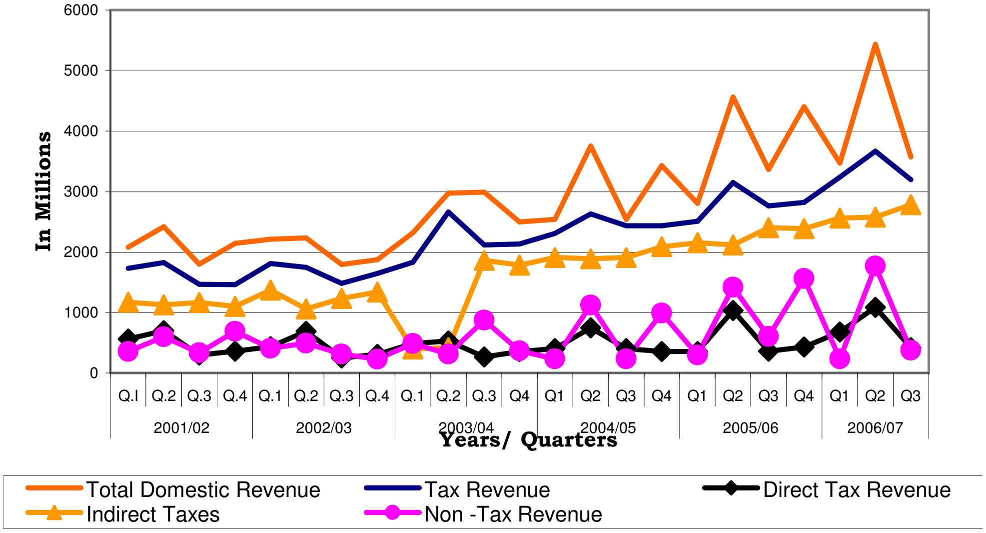
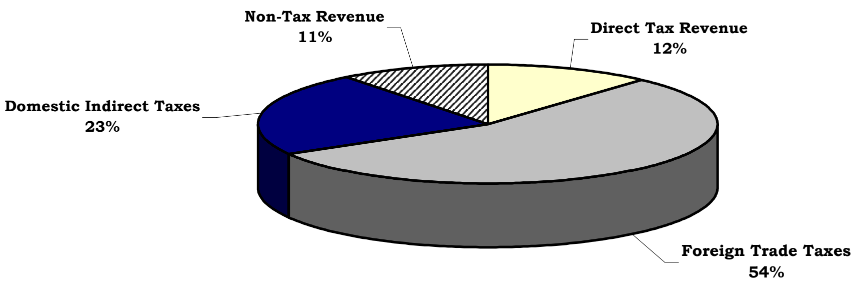


Fig.VI.2 Domestic Revenue (by Major Components)



Total domestic revenue collected in the third quarter of 2006/07 reached Birr 3.57 billion, which was 34.2 percent lower and 6.1 percent higher than the revenue mobilized in the preceding quarter and a year earlier.

Tax revenue slowed down by 12.8 percent over the previous quarter but increased by 15.7 percent vis-à-vis the same period of last year. Indirect taxes accounted for Birr 2.78 billion or 87 percent of the total tax revenue.

Revenue from indirect taxes rose by 7.8 percent and 15.8 percent compared to the previous quarter and the same quarter of 2005/06 fiscal year. In a similar development, direct tax revenue, which comprises personal and business income taxes as well as withholding tax on import and interest income tax, showed significant decline in contrast with the previous quarter and stood at Birr 415.3 million due to seasonality factors. Year-on-year basis, however, direct tax revenue went up by 14.5 percent owing to remarkable increase in withholding tax and interest income.

6.2 Expenditure

Total Federal Government expenditures stood at Birr 6.14 billion during the quarter under review, of which Birr 1882.8 million (or about 30.7 percent) went to finance current expenditure and Birr 2089.1 million (or 34 percent) to carry out various development programs. Regional transfers and special programs constituted 35 and 0.13 percent of the Federal Government expenditures of the review quarter.

Total Federal Government expenditure was 8.4 percent lower and 16.3 percent higher than the expenditure recorded in the previous quarter and the same quarter of last year. The contraction in capital expenditure by 17.3 percent and regional transfers by 21.8 percent as compared with the previous quarter, was the main reason behind the decline in total expenditure. In contrast, owing to 62.5 percent surge in expenditure on general services, the quarterly recurrent expenditure jumped by 34.8 percent to Birr 1.88 billion. On annual basis, recurrent expenditure rose by 14.9 percent .

Table VI. 3 Summary of Federal Government Expenditure by Component

(In Millions Of Birr)

Particulars	2005/06	2006/07			Percentage Change		Performance Rate
	Qtr.III	Budget	Qtr.II	Qtr.III			
	[A]	[B]	[C]	[D]	[D/A]	[D/C]	[D/B]
Total Expenditure	**5277.97**	**29895**	**6698.56**	**6136.9**	**16.3**	**-8.4**	**20.5**
1. Current Expenditure	**1638.47**	**8282**	**1396.66**	**1882.8**	**14.9**	**34.8**	**22.7**
- General Services	986.09	4095	739.84	1201.9	21.9	62.5	29.4
- Economic Services	81.53	512	83.82	81.1	-0.5	-3.2	15.8
- Social Services	317.54	1321	289.5	269.8	-15.0	-6.8	20.4
- Debt Service	251.9	1481	277.3	307	21.9	10.7	20.7
-Contingency and Others	1.41	872	6.2	23	1531	271.0	2.6
2. Capital Expenditure	**2061.9**	**12557**	**2526**	**2089.1**	**1.3**	**-17.3**	**16.6**
- Economic Development	1498.4	8966	1761.2	1201.8	-19.8	-31.8	13.4
- Social Development	506.1	2977	689.19	822.6	62.5	19.4	27.6
- General Development	57.4	615	75.6	64.7	12.7	-14.4	10.5
3. Regional Transfers	**1562.6**	**9056**	**2759.4**	**2157**	**38.0**	**-21.8**	**23.8**
4. Special Programs	**15**	**0**	**16.5**	**8**	**-46.7**	**-51.5**	

Source: Ministry of Finance and Economic Development

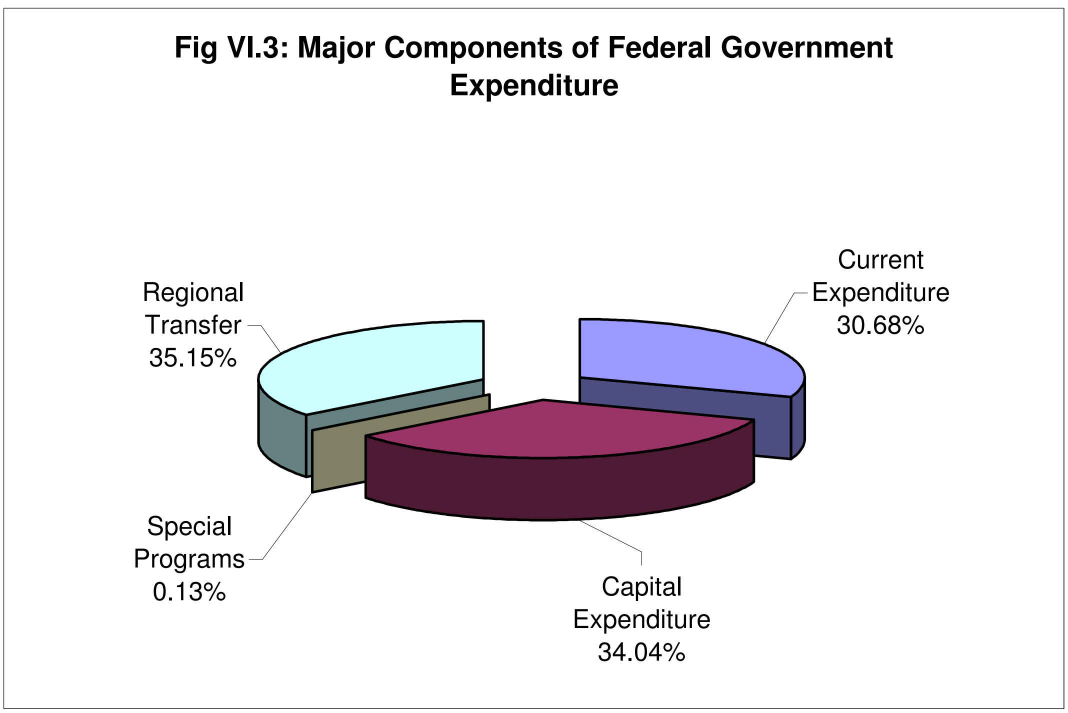
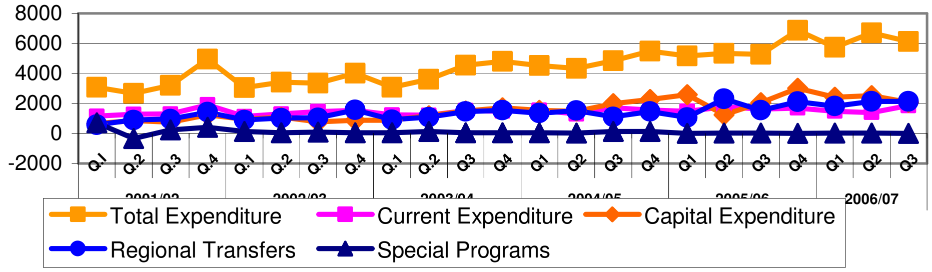


Fig. VI.4 Quarterly Developments in Federal Government Expenditure By Components

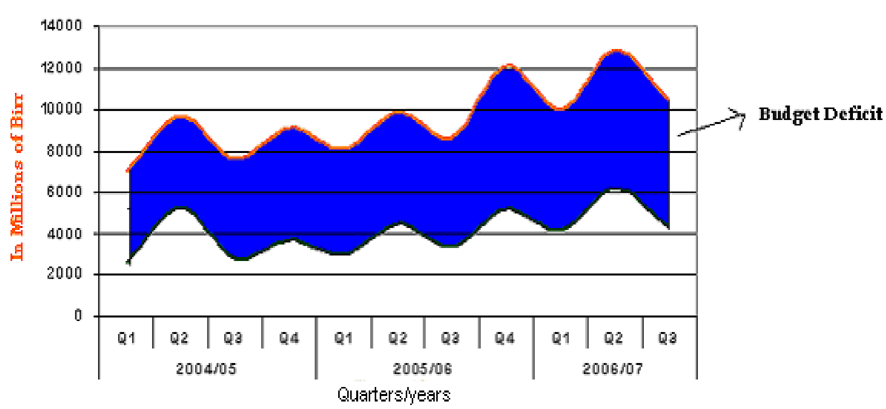


6.3 Deficit Financing

As indicated earlier, Federal Governmen t budgetary operations resulted in an overall deficit (including grant) of Birr 1767.1 million, which was tripled that of the preceding quarter due to the 29.8 percent drop in total revenue and grants vis-à-vis 8.4 percent decline in total expenditure. On annual basis, however, the deficit in the review quarter was lower by 3.3 percent.

The fiscal deficit was primarily financed by net domestic borrowing of Birr 1.6 billion, of which Birr 1298.4 million (or 79 percent) was from the banking system. Net external borrowing was negative in the review period implying a net repayment of Birr 540.7 million to external lenders.

Fig VI. 5 Federal Government Finance During the Third Quarter Of F.Y 2006/07



VII. INVESTMENT

During the third quarter of 2006/07, the Ethiopian Investment Agency and Regional Investment Offices have approved 1,326 investment projects with a total investment capital of Birr 19.1 billion. The number of approved investment projects was higher by 16.7 percent vis-à-vis the preceding quarter while the associated capital was lower by 25.1 percent. Year- on -year basis, the approved number of investment projects declined by 2.3 percent while their registered capital increased by 63.1 percent.

Ownership wise, all investment projects approved were private. Of the total, 76.6 percent of the investment projects which accounted for 58.8 percent of the capital were domestically owned while foreign investment projects constituted the balance. No public investment project was registered during the review period.

Upon commencement, the approved investment projects are expected to create employment opportunities for 63,064 citizens on permanent and 121,868 citizens on temporary basis.

All in all, since 1992, 23177 investment projects having Birr 295.6 billion capital were approved. Of these, 17 percent have gone operational. Moreover, 99.6 percent of the projects with an investment capital of Birr 266 billion were private. Foreign investment accounted for 13.3 percent of the total projects and Birr 101.7 billion of the capital

Table VIII.1. Number, Capital and Employment Creation Capacity of Approved Projects

(Capital in million Birr)

Type of Projects	Items	2005/06 Q.III A	2006/07 Q.II B	2006/07 Q.III C	Percentage changes C/A	Percentage changes C/B
1.Total investment	Number	1357	1,136	1,326	-2.3	16.7
	Capital	11726.65	25,540.06	19,123.18	63.1	-25.1
	Permanent Employment	40227	98,402	63,064	56.8	-35.9
	Temporary Employment	58356	57930	121868	108.8	110.4
2. Private investment	Number	1355	1,136	1,326	-2.1	16.7
	Capital	10681.56	25,540.06	19,123.18	79.0	-25.1
	Permanent Employment	40227	98,402	63,064	56.8	-35.9
	Temporary Employment	58356	57930	121868	108.8	110.4
2.1 Domestic Investment	Number	1159	879	1,015	-12.4	15.5
	Capital	4204.46	5582.76	11246.12	167.5	101.4
	Permanent Employment	24444	74,286	29,845	22.1	-59.8
	Temporary Employment	29638	42,780	80,195	170.6	87.5
2.2 Foreign Investment	Number	196	257	311	58.7	21.0
	Capital	6477.11	19957.30	7877.05	21.6	-60.5
	Permanent Employment	15783	24,116	33,219	110.5	37.7
	Temporary Employment	28718	15,150	41,673	45.1	175.1
3. Public investment	Number	2	-	-	-	-
	Capital	1045.083	-	-	-	-
	Permanent Employment	-	-	-	-	-
	Temporary Employment	-	-	-	-	-

Source: Ethiopian Investment Agency

Looking by sector, real estate, renting and business activities accounted for about 35.2 percent of the total number of approved investment projects, followed by manufacturing (21.0 percent), agriculture (20.9 percent) and hotel and restaurant (7.8 percent). In terms of total investment capital, agriculture accounted for the lion's share (29.5 percent) followed by manufacturing (24.2 percent), real state, renting and business activities (18.17 percent) and hotel and restaurant (11.2 percent). The approved investment projects in the agriculture sector are expected to create 39.4 percent of the total permanent employment to be followed by manufacturing (24.1 percent), real state, renting and business activities (13.3 percent) and hotel and restaurant (8.5 percent). Regarding temporary employment, 71.2 percent is expected to be in agriculture, 9.1 percent in manufacturing, 8.6 percent in real state, renting and business activities and 4.8 percent in construction.

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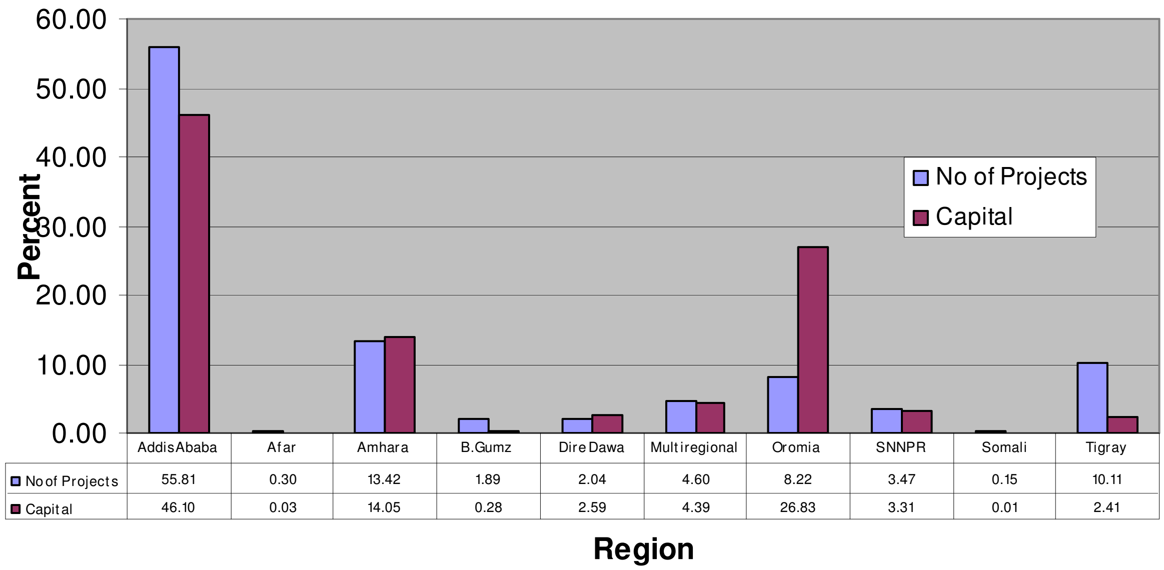
Table VII.2 Sector Distribution of Number, Capital and Employment Creation Capacity Approved projects during 3rd quarter of 2006/07

Sector	No. of Proj.	Share	Capital (in Million Birr)	Share	Perm. Emp.	Share	Temp. Emp.	Share
Agriculture, hunting and forestry	277	20.89	5,632	29.45	24,840	39.39	86,956	71.35
Construction	42	3.17	239.87	1.25	1,114	1.77	5,825	4.78
Education	67	5.05	732.19	3.83	3,730	5.91	1,171	0.96
Electricity, gas, steam and water supply	1	0.08	10.08	0.05	16	0.03	40	0.03
Fishing	2	0.15	92.79	0.49	70	0.11	230	0.19
Health and social work	42	3.17	1,651.69	8.64	3,113	4.94	1,411	1.16
Hotels and restaurants	104	7.84	2,135.00	11.16	5,382	8.53	3,906	3.21
Manufacturing	279	21.04	4,634.21	24.23	15,223	24.14	11,042	9.06
Mining and quarrying	6	0.45	41.80	0.22	235	0.37	239	0.20
Other community, social and personal service activities	3	0.23	183.25	0.96	386	0.61	195	0.16
Real estate, renting and business activities	467	35.22	3,473.86	18.17	8,406	13.33	10,485	8.60
Transport, storage and communication	23	1.73	85.22	0.45	262	0.42	226	0.19
Wholesale, retail trade & repair service	13	0.98	211.18	1.10	287	0.46	142	0.12
Grand Total	**1,326**	**100**	**19,123**	**100**	**63,064**	**100**	**121,868**	**100**

Source: Ethiopian Investment Agency

Fig. VII 1:Approved Investment Projects by Region During the Third Quarter of 2006/07



	Addis Ababa	Afar	Amhara	B.Gumz	Dire Dawa	Multiregional	Oromia	SNNPR	Somali	Tigray
No of Projects	55.81	0.30	13.42	1.89	2.04	4.60	8.22	3.47	0.15	10.11
Capital	46.10	0.03	14.05	0.28	2.59	4.39	26.83	3.31	0.01	2.41

During the quarter under review, a significant proportion (55.8 percent) of the total number of approved investment projects went to Addis Ababa, followed by Amhara (13.4 percent) and Tigray (10.1 percent). In terms of approved investment capital, Addis Ababa attracted 46.1 percent followed by Oromia (26.8 percent) and Amhara (14.1 percent). Cross-regional projects accounted for 4.4 percent of the total approved investment capital.

VIII. QUARTERLY MANUFACTURING SECTOR DEVELOPMENTS

8.1 Basic Performance Indicators of the Manufacturing Sector

As it has been the case for the last consecutive quarters, there was no change in the number of firms during the third quarter of 2006/07. The data obtained from the Central Statistical Agency (CSA) revealed that a total of 90,460 people were engaged in the manufacturing industry, of which 79,192 (87.5 percent) were permanent employees and the remaining 11,268 (12.5 percent) seasonal or temporary workers. While the number of permanent employees showed a marginal increase of 2.8 percent vis-à-vis the preceding quarter, the number of temporary employees decreased by 12.3 percent and 21.8 percent from the preceding quarter and the same period of last year, respectively.

Among the industrial groups, food industry remained the major employer, employing around 21.8 percent of the total work force in the sector followed by textile industries which absorbed around 13.3 percent. On the contrary, tobacco-manufacturing firms were the least in terms of creating employment opportunities as they offered job only for 775 persons, which accounted for 0.9 percent of the total employment in the sector.

Table VII.1: - Performance indicators of the manufacturing sector

Quarter	Number of Firms	Persons Engaged			Revenue from sales ('000 Birr)			Capacity Utilization (%)
		Permanent	Temporary	Total	Local	Export	Total	
2005/06 QIII (A)	910	79,006	14,405	93,411	3,005,276	336,172	3,341,448	63.6
2006/07QII (B)	910	77,059	12,848	89,907	3,612,341	170,044	3,782,385	54.3
QIII (C)	910	79,192	11,268	90,460	3,470,836	150,816	3,621,652	54.5
Percentage Changes								Change in %Points
[C/A]	-	0.2	(21.8)	(3.2)	15.5	(55.1)	8.39	(9)
[C/B]	-	2.8	(12.3)	0.6	(3.9)	(11.3)	(4.2)	0

Source: CSA

[1] The manufacturing industry here refers to the medium and large scale where only ten or more persons are engaged and use power driven machines in the production process.

During the quarter under review, a total of Birr 3.6 billion sales revenue was earned by the manufacturing sector, which showed 4.2 percent decline over the previous quarter but 8.4 percent increase compared to the same period of last year. The lion's share amounting to 95.8 percent of the revenue was generated from local sales while the remaining 4.2 percent was generated from exports.

According to CSA's Quarterly Manufacturing Business Survey, food industry and manufacturing of beverage products contributed the largest share to total revenue during the quarter as they generated 22.4 and 15 percent of the total revenue, respectively. Wearing apparel industries were at the bottom of the list with revenue amounting only to 0.4 percent of the total.

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8.2 Developments in Capacity Utilization and Usage of Imported Raw Materials

High dependency on imported raw materials and low level of capacity utilization have remained the typical feature of Ethiopian manufacturing sector.

Table VIII.2 depicts that the main reasons for high dependency in imported raw materials are unavailability of raw materials in the local market (64.3 percent), lack of sufficient local supply (10.9 percent), problems related to quality (9.8 percent) and other reasons (14.9 percent). The fact that demand for raw materials by local manufacturing industries could not be satisfied from domestic sources due to major reasons specified above calls for the government and other stakeholders to give attention to encourage the production of necessary raw materials locally and there by reduce the outflow of scarce foreign exchange resource.

Table VIII.2: - Percentage of establishments by reasons for using imported raw materials

Quarter	Type of Reason					Total
	Lack of sufficient supply locally	Not available locally	Local supply is not reliable	Quality of locally available raw material is not reliable	Other reasons	
2005/06QIII	15.8	53.8	21.9	8.5	-	100
2006/07QII	29.1	56.8	9.2	5.0	-	100
QIII	10.9	64.3	-	9.8	14.95	100

Source: CSA

As indicated in Table VIII.1, the manufacturing firms were utilizing only 54.5 percent of the total capacity. In other words, 45.5 percent of the total capacity remained unexploited. No change in capacity utilization was observed in the third quarter of 2006/07 as compared with the previous quarter. However, quite a significant decline in capacity utilization to the tune of 9 percentage points was noted compared with the same quarter of last year.

CSA's quarterly survey indicated that a relatively high degree of capacity utilization was observed in manufacturing of wood and wood products and cork (89.4 percent) while a low level of capacity utilization was observed in manufacturing of furniture (41.2 percent).

The main reasons for the observed under capacity utilization rate differ from time to time. Nevertheless, shortage of raw materials and lack of demand /market/ seem to be the main and more persistent reasons.

Table VIII.3: - Percentage distribution of establishments by reason for not working at full capacity

Reasons for not working at full capacity	2005/06	2006/07	
	Qtr.III	Qtr. II	Qtr.III
Shortage of raw material	11.6	13.76	15.8
Shortage of spare parts	0.4	0.14	4.9
Shortage of foreign exchange	0.0	-	-
Lack of demand/ market	62.0	62.27	57.6
Shortage of working capital	2.4	1.28	4.2
Problem with water & electricity	10.8	13.9	12.2
Repeated breakage of machinery	2.5	4.11	2.7
Problem with workers	0.2	0.14	-
Lack of skilled man-power	6.8	-	-
Govt.rules and regulations	0.0	0.14	1.6
Others	3.2	4.26	0.9
Total	100	100	100

Source: CSA

IX. INTERNATIONAL ECONOMIC DEVELOPMENTS

9.1 Overview of World Economy[1]

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.