I. OVERVIEW

The third quarter of 2006/07 marked a rise in the general level of inflation to 3.6 percent from 2.6 percent last quarter and 2.6 percent in the same period of last year. The surge in the food inflation, as it was the case in the previous quarters, continued to account for the major part of the rise in the general inflation, as the non-food inflation showed no change vis-à-vis the level in the preceding quarter.

With regard to monetary developments, broad money supply (M2) rose by 7 percent and 20.3 percent on quarterly and annual basis, respectively. The quarterly and annual increase in M2 was mainly due to the expansion of domestic credit that more than offset the decline in the net foreign assets.

Similarly, reserve money, which is composed of currency in circulation and deposits of commercial banks at the NBE, expanded by 11 and 8.4 percent on quarterly and annual basis, respectively. This continuous expansion of reserve money was one of the major challenges to the monetary policy during the third quarter of 2006/07. Another challenge was the continued negative real interest rate owing to higher inflation. Savings deposit rate invariably stood at the minimum rate of 3 percent while the weighted demand deposit rate fell to 0.05 percent from 0.06 percent in the preceding quarter. On the other hand, the weighted time deposit rate rose from 4.01 percent to 4.05 percent and the average commercial banks' lending rate exhibited no change since March 2003.

The quarter under review witnessed the growth of the banking sector as revealed by the opening up of twenty additional bank branches thereby raising their total number to 470. There has also been an 11.6 percent increase in the total capital of the banking system and 20 percent pickup in the amount of resources mobilized. Regarding disbursement of fresh loans to the tune of Birr 3.9 billion, the quarter witnessed a 10.7 percent fall as compared to that of the preceding quarter. Meanwhile, the total outstanding credit of the banking system reached Birr 42.6 billion which was 2.8 percent and 15 percent higher than the preceding quarter and the same period of last year, respectively. On the other hand, no change was observed with respect to the number of insurance companies and their branches. However, the total capital of the insurance industry grew by 7.8 percent as compared to the same period of last year.

In the external sector, the overall balance of payments deficit stood at USD 93 million which was USD 81 million above that of the preceding quarter. The widening of the deficit in overall balance was the result of the upsurge in trade deficit and a drop in public transfers. In the review quarter, the merchandise trade deficit stood at USD 1095.3 million exhibiting USD 46.6 million increase over the preceding quarter.

With regard to exchange rate movements, both the average interbank and parallel market exchange rates exhibited a respective depreciation of 1.3 percent and 0.6 percent over the preceding quarter to Birr 8.8315/USD and Birr 8.9553/USD. Consequently, the parallel market premium went down to 1.4 percent from 2.1 and 5.1 percent in the preceding quarter and the corresponding period of last year, respectively.

During the review quarter, fiscal operations of the Federal government resulted in an overall fiscal deficit of Birr 1767.1 million compared with Birr 475.2 million deficit of the preceding quarter. However, the deficit was lower than that of the same period of last year by 3.3 percent. The aforementioned fiscal deficit was primarily financed by net domestic borrowing of Birr 1.6 billion.

Regarding investment, 1326 investment projects with a total capital of Birr 19.1 billion were approved in the review quarter, 16.7 percent higher than the previous quarter. Domestic investors own about 77 percent of the approved projects while the balance was under the ownership of foreigners. These projects upon completion are expected to create job opportunities for 63,064 permanent and 121,866 temporary workers.

Developments in the manufacturing sector during the quarter under review showed no change in the number of firms. However, the number of permanent employees in the sector rose by 2.8 percent and that of temporary employees declined by 12.5 percent as compared to the preceding quarter.

In the international front, the world economic growth is expected to moderate at 4.9 percent in 2007. Growth in U.S. economy is to slowdown to 2.2 percent from 3.3 percent in 2006. The Euro area which is experiencing its fastest growth is expected to ease as a result of contractionary monetary and fiscal policies and the appreciation of the Euro against USD. Similarly, Japan's economic growth is envisaged to continue at about 2.2 percent as in 2006. Economies of emerging markets and developing countries are to enjoy further remarkable growth. Such prospects in global economy have positive implications to the Ethiopian export sector.