# I. OVERVIEW

The fourth quarter of 2006/07 marked a rise in the general level of inflation to 5.3 percent from 3.6 percent registered in the preceding quarter and 5.1 percent in the same period of last year. The surge in the food inflation, as it was the case in the preceding quarters, continued to account for the major part of the rise in the general inflation, as the non-food inflation increased in lesser margin vis-à-vis the level in the preceding quarter.

With regard to monetary developments, broad money supply (M2) rose by 6.3 percent and 22.2 percent on quarterly and annual basis respectively. The quarterly and annual increase in M2 was the result of both the expansion of domestic credit and the build up of net foreign assets. Similarly, reserve money, which is composed of currency in circulation and deposits of commercial banks at the NBE, expanded by 11.1 and 29.4 percent on quarterly and annual basis, mainly due to increases in commercial banks' deposit at the NBE. Real interest rate continued to remain negative due to higher inflation. Savings deposit rate invariably stood at the minimum rate of 3 percent while the weighted demand deposit rate slightly increased to 0.06 percent from 0.05 percent in the preceding quarter. On the other hand, the weighted time deposit rate rose from 4.05 percent to 4.08 percent and the average commercial banks lending rate at 10.5 percent exhibited no change.

The quarter under review witnessed the growth of the banking sector as revealed by the opening of seventeen additional bank branches thereby raising the total number thereof to 487. Total capital of the banking system increased by 30.2 percent. The amount of resources mobilized also picked up by 34.2 percent. Banks disbursed fresh loans to the tune of Birr 4.3 billion, witnessing 12 percent quarterly increase. Meanwhile, the total outstanding credit of the banking system reached Birr 44.3 billion, 3.9 percent and 9.6 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 which stood at 9. However their branches increased by 3 to 146 and their total capital by 3.5 percent as compared to the same period of last year.

In the external sector, exports increased by 26.2 percent and imports by 0.9 percent compared to the corresponding quarter of 2005/06. Hence, the merchandise trade deficit narrowed to USD 956.7 million from USD 1052.5 million registered in the preceding quarter. Similarly net services rose by 6.7 percent significant improvement in transportation services. Private transfers also surged by 30.3 percent and official transfers by 221 percent. Therefore, current account balance including public transfers, turned to a surplus during the review quarter. Non-monetary capital however slowed down by 42 percent due to lower disbursements and FDI. As a result of the developments in the external sector the overall balance of payments registered a surplus of USD 171.7 compared to deficits of USD 53.6 million and USD 55.5 million recorded during the preceding quarter and the same quarter of last year, respectively.

With regard to exchange rate movements, both the average interbank and parallel market exchange rates exhibited nominal depreciations of 1.1 percent and 1.4 percent over the preceding quarter to Birr 8.9275/USD and Birr 9.0795/USD. Consequently, the parallel market premium went up to 1.7 from 1.4 percent in the preceding quarter, yet significantly lower than 3.51 percent recorded during the corresponding period of last year.

During the fourth quarter under review, fiscal operations of the Federal Government, total revenue and grants surged by 28.7 percent year-on-year basis while total expenditure 27.7 percent. Yet, total expenditure exceeded total revenue and grants and resulted in a wider overall deficit which was largely financed by net domestic borrowing.

In the review quarter, 1693 investment projects with a total capital of birr 18.6 billion were registered. These projects, upon completion, are expected to create job opportunities for over 228 thousand people on permanent and temporary basis. Of the total investment licensed, domestic investors accounted for about 81 percent. Most of the investment projects are in agriculture, manufacturing, real estate and hotels and restaurants.

Developments in the manufacturing sector during the quarter under review showed no change in the number of firms which stood at 910. However, the number of permanent employees declined by 2.4 percent to 77,297 while temporary employment rose by 3.4 percent to 11,649 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 rebound to 4.0 percent in the second quarter of 2007. The Euro area GDP growth moderated to 0.3 percent compared to 0.7 percent in the previous quarter although it is expected to continue to grow at sustained rates in remaining months of the year. On the other hand, real GDP growth in Japan was 0.1 percent compared to 0.8 in the preceding quarter due to a slowdown in consumption and private residential investment. Economies of emerging markets and developing countries are expected to enjoy further remarkable growth. For three years in a row, Sub-Saharan Africa (SSA) recorded an average growth rate of 5.7 percent in 2006 and the outlook remains positive. Oil price remained very volatile during the first eight months of 2007 and are likely to remain high in the remaining months. Coffee prices are also expected to continue to rise. Such developments in the global economy are expected to have both positive and negative implications to the Ethiopian economy.