

IX. INTERNATIONAL ECONOMIC DEVELOPMENTS

9.1 Overview of World Economy¹

In the context of the financial market turbulence, global economic activity, while remaining resilient overall, continues to be dampened by the weakening of the major developed economies. Survey evidence in April indicated that global economic activity might have decelerated further, particularly in the manufacturing sector. However, the relative robustness of economic growth in emerging markets continues to support the pace of global economic expansion.

In the United States the pace of economic activity remained subdued in the first quarter of 2008. Real GDP increased at a quarterly annualised rate of 0.6% according to advance estimates, the same growth rate as in the final quarter of 2007. The largest contribution to GDP growth came from an adjustment in inventories, which added 0.8 percentage point to annualised growth and more than compensated for a contraction in final domestic demand.

Net exports of goods and services also supported GDP growth, albeit to a lesser extent than in previous quarters.

In Japan there has been a slowdown in economic activity in recent months, following the revision of the Building Standard Law in June 2007, which resulted in a significant drop in construction starts in the second half of last year. Overall, the survey evidence points to a less favourable short-term outlook for the Japanese economy.

In the United Kingdom the preliminary estimate of quarterly real GDP growth in the first quarter of 2008 suggests a moderation of growth (from 0.6% in the previous quarter to 0.4%).

Despite weakening global demand conditions related to the slowdown in large advanced economies, economic activity continued to be strong in emerging Asia at the beginning of 2008. Strong demand within this region and from other emerging economies contributed to the resilience of exports.

¹ Excerpts from European Central Bank, Monthly Bulletin, May 2008

In China, real GDP increased by 10.6% in annual terms in the first quarter of 2008. Economic growth was mainly supported by domestic demand, with the growth rate of urban fixed asset investment and retail sales of consumer goods accelerating to 25.9% and 20.6% respectively in nominal terms. Exports, in particular to the United States, continued to slow down. The cumulated trade surplus during the first three months of 2008 was USD 41.1 billion, which represents a fall of 11% compared with the same period last year.

In Latin America, the pace of economic activity remained dynamic, with industrial production in February rising by 5.7% in Argentina, 9.7% in Brazil and 5.4% in Mexico compared with a year earlier. Retail sales also remained strong, in particular in Brazil, where the volume of sales increased by 8.2% year-on-year in February.

9.2 Inflationary Developments

As to price developments, headline CPI inflation in the US remained at 4.0% in March, unchanged from February. Upward pressures on headline inflation owing to further energy price increases persisted in subsequent months. The core

CPI index (excluding food and energy) increased by 2.4% in March compared with a year earlier, slightly up from 2.3% in February.

Consumer price inflation has recently picked up in Japan as a result of the rise in the price of imported raw materials, while domestic inflationary pressures have remained subdued. In March 2008 the annual change in the CPI (and in the CPI excluding fresh food) was 1.2%, after 1.0% in February; this increase was mostly driven by the prices of energy and processed food products. The annual change in the CPI excluding food and energy was 0.1% in March, after -0.1% in February.

In March 2008 annual HICP inflation in the United Kingdom remained unchanged at 2.5%, as positive contributions from higher transport, gas and electricity prices were largely offset by negative contributions from furniture, recreation and culture prices.

The recent upsurge in food and other commodity prices has contributed to a rise in headline consumer price inflation in most emerging economies. Consumer price inflation excluding food and energy, although still at more moderate

levels, has also been rising. In China, CPI inflation was at 8.0% in March, after 8.7% in February. Given its high level of self-sufficiency in grains, so far increases in food prices in China have been mainly caused by a temporary drop in the supply of livestock, rather than by high international grain prices. However, the continuous upward cost pressure for a range of commodities, energy resources and raw materials raises the risk of stronger price increases in a broader segment of consumer goods.

In Latin America, robust economic activity and rising commodity prices are leading to a pick-up in headline inflation across the region. In March consumer prices were 8.8% higher compared with a year earlier in Argentina, 4.7% higher in Brazil and 4.3% in Mexico.

Central banks in the advanced economies continued to cut interest rates to stimulate their economies while central banks in developing countries were tightening monetary policy because of the growing inflationary pressures. On 30 April, the US Federal Open Market Committee decided to lower its target for the federal funds rate by 25 basis points to 2.0%. On the other hand, the Bank of Japan decided to leave its target for the

uncollateralized overnight call rate unchanged at 0.50% at its meeting on 9 April 2008. Similarly, the Bank of England's Monetary Policy Committee decided to leave its main policy rate unchanged at 5.00% on 8 May 2008.

In contrast, the People's Bank of China raised the banks' reserve requirements ratio by 50 basis points in April 2008 for the third time this year, to 16%. In response to the increase in inflation and inflationary expectations, at its 15-16 April meeting the Central Bank of Brazil also raised the policy rate by 50 basis points to 11.75%.

9.3 Commodity Markets

In April oil prices continued their surge to unprecedented levels well above USD 100, standing at USD 116.5 on 6 May. Oil prices are now around 24% higher than at the beginning of the year. Given OPEC's policy of restricting oil production and its limited spare capacity, markets remain concerned about long-term oil supply. The International Energy Agency revised downwards its global oil demand and supply forecasts and identified downside risks for oil supply in the event of project delays for new production build-ups. Markets also

perceived downside risks to global fuels supply, as increased food price inflation initiated a reassessment of existing biofuel policies in some OECD countries. Amid tight market conditions, both continuous geopolitical tensions and strikes at a Scottish refinery put additional upward pressure on oil prices.

Looking ahead, oil prices are likely to stay at elevated levels by historical standards in the near term and to remain very sensitive to small changes in the supply-demand balance, as well as in the geopolitical environment.

In April the prices of non-energy commodities partly recovered from the sell-off in commodity markets in mid-March. In particular, food prices picked up again owing to increased competition for acreage, amid strong demand from emerging economies and increased biofuel production. As plantings were shifted from maize and soybeans to wheat, the price of the latter eased, but that of maize and soybeans continued to rise. Price pressures were exacerbated by an increasing number of export bans and restrictions on food commodities (i.e. for rice) in emerging markets. In aggregate terms, the price index for non-energy commodities (denominated in US

dollars) was approximately 23% higher towards the end of April than a year earlier.

Coffee prices which were on the rise during the past few months declined in March and April 2008. In March, ICO's composite indicator price showed a monthly decline of 2 percent and reached 136.2 US cents per pound. In April, it further declined by 7.1 percent and reached 126.6 US cents per pound.

9.4 Exchange Rate Developments

The US dollar continued to depreciate against all major currencies for the most part of the first few months of 2008. In March 2008, the US dollar depreciated by 5.2 percent against the Euro and it further depreciated by 1.5 percent in April. Against the yen, it depreciated by 5.9 percent in March 2008 while it appreciated by 1.9 percent in April. After an appreciating trend for three consecutive months, the US dollar depreciated by 1.9 percent against the Pound Sterling in March 2008. However, it again appreciated by 1 percent in April.

The Chinese [reminibi](#) continued its gradual appreciation against the US

dollar. It appreciated by 1 percent on monthly basis and 9.4 percent on annual basis and reached 7 in April 2008.

9.5 Impact of Global Economic Developments on Ethiopia's Economy

As Ethiopia is a small open economy, it continues to face the shocks that emerge at the international level. The major risk to the Ethiopian economy is the surge in the price of oil at the international market. This continuous increase in oil prices has escalated the country's oil import bill. During the nine months of 2007/08 fiscal year, fuel imports amounted to USD 1,046 million, 48 percent higher than last year same period. It was also close to the USD 1.0 billion, foreign exchange earned by the country from exports. Thus, the rising oil price is putting high strains on the country's foreign exchange reserves.

The rise in the prices of oil and other commodities in the international market is also expected to have impacts on domestic prices through the pass-through effect contributing to the current high inflationary pressure.

On the other hand, rising commodity prices such as pulses and oil seeds are expected to boost export earnings and offset to a certain extent the adverse impact of the rise in oil prices on the current account. However, the recent slow down in the international price of coffee may offset the gain from the improvement in the other commodity prices.

The weakening of the US dollar against all major currencies is also expected to boost demand for Ethiopia's exports in Europe and Asia, which are the two major markets for the country's exports.