

XI. INTERNATIONAL ECONOMIC DEVELOPMENTS

11.1 Overview of World Economy⁴

Global economic conditions have further worsened, aggravated by the financial crisis and the severe strains on banking systems and credit conditions worldwide. Recent economic indicators point to a further weakening in global economic activity, particularly in the manufacturing sector. On the other hand, global inflationary pressures have eased, owing to the sharp decrease in commodity prices.

According to advance estimates, real GDP contracted at an annualized rate of 0.3% in the third quarter of 2008 in the United States, compared with an expansion of 2.8% in the preceding quarter. The marked deceleration primarily reflects a negative contribution from personal consumption expenditure as the effect of the US government's fiscal-stimulus package fades, the

ongoing housing market correction and weakness in investment in equipment and software. Despite a slowdown in external demand, net trade continued to contribute positively to growth in the third quarter.

In Japan, economic conditions have continued to worsen, reflecting sluggish domestic demand and a further slowdown in exports, although credit conditions have tightened to a lesser extent than in other advanced economies. As a result of the global slowdown and moderating profit growth, business confidence has continued to deteriorate.

Euro area real GDP fell by 0.2% quarter-on-quarter in the second quarter of 2008, following growth of 0.7% in the previous quarter. The decline was largely due to a decrease in domestic demand excluding inventories.

Output in the United Kingdom declined by 0.5% quarter on quarter in the third quarter of 2008, after stagnating in the second quarter. This is the first time in

⁴ Excerpts from European Central Bank, Monthly Bulletin, November 2008

16 years that the economy has contracted on a quarter-on-quarter basis. Confidence indicators have also generally trended downwards in recent quarters and have remained below long-term averages.

In China, real GDP growth slowed in the third quarter of 2008 to an annual rate of 9.0% from 10.1% in the previous quarter. The weaker GDP number was mainly due to tight macroeconomic policies in the first half of the year and deteriorating external conditions, but also stemmed in part from a temporary suspension of production during the Olympic Games.

11.2 Inflationary Developments

As regards price developments, annual CPI inflation in the US eased somewhat to 4.9% in September, but remained high by historical standards. The deceleration reflected mostly a retreat in energy cost pressures. The annual rate of inflation excluding food and energy was unchanged in September from the previous month, standing at 2.5%.

Euro area HICP inflation declined to 3.6% in September from 3.8% in August.

In Latin America, the pace of economic activity has been showing signs of decelerating, while inflationary pressures are in general showing signs of abating, albeit from elevated levels. In Brazil, industrial production grew at an annual rate of only 1.9% in August 2008, after 8.8% in July. In Argentina, the pace of economic activity has moderated, with industrial production expanding by 3.7% on an annual basis in August, down from the exceptionally high increase of 9.1% in July. Economic activity in Mexico remained weak in August, with industrial production contracting by 1.6% on an annual basis.

It further went down to 3.2% in October 2008.

In September, 2008 annual CPI inflation in Japan was unchanged at 2.1%. Inflation peaked in July at 2.3% and moderated thereafter owing to the decrease in global commodity prices and the slowdown in global activity. Excluding food and energy, Annual CPI inflation returned to positive territory

(0.2%) in September, from 0.0% in August.

In the United Kingdom, annual HICP inflation rose to 5.2% in September, from 4.7% in August, reflecting a broad-based increase across HICP components.

In China, annual CPI inflation fell further in September to 4.6%, from 4.9% in August. In Brazil, annual CPI inflation stood at 6.3% in September, up from 6.2% in the previous month. CPI inflation in Argentina has remained at elevated levels, albeit declining slightly to 8.7% in September. Annual inflation in Mexico declined slightly to 5.5% in September, from 5.6% in August.

Central banks all over the world have been cutting interest rates and providing liquidity to money markets in order to ease the impact of the global financial crisis. On 29 October, 2008 the US Federal Open Market Committee decided unanimously to lower its target for the federal funds rate by 50 basis points to 1%. The decision followed the half-point reduction the Federal Reserve System coordinated with the European Central Bank and four other central banks on 8

October. The Federal Reserve System, in cooperation with the US Treasury and a number of foreign central banks, also announced further initiatives to enhance its liquidity facilities and to provide support to financial markets in view of deteriorating conditions.

Similarly, on 31 October, the Bank of Japan decided to lower the Bank's target for the uncollateralized overnight call rate by 20 basis points to 0.3%.

On 8 October 2008 the Bank of England's Monetary Policy Committee, in coordination with other central banks, decided to cut its main policy rate by 50 basis points to 4.5%. On 6 November it decided to make a further reduction by 150 basis points to 3.0%. This decision was taken against the background of a substantial shift in the prospects for inflation in the United Kingdom and a very marked deterioration in the outlook for domestic and global economic activity.

With inflation moderating and the global financial tensions intensifying, the People's Bank of China cut policy rates twice in October (by 27 basis points each

time). This brought the one-year lending rate to 6.66% and the one-year deposit rate to 3.60%. The reserve requirement ratio was also lowered further by 50 basis points.

11.3 Commodity Markets

Oil prices continued to decline and reached USD 62.6 per barrel on 5 November 2008, which is 34% lower than at the beginning of the year. As the financial turmoil intensified, prices were pulled down by growing fears of a global recession and the need for financial institutions to liquidate their assets. Over the medium term, however, market participants still expect higher prices, with futures for December 2009 trading at around USD 76 per barrel.

11.4 Exchange Rate Developments

The US dollar gained ground against major currencies such as the Euro and Pound Sterling during the third quarter of 2008. The average exchange rate of the US dollar against the Euro appreciated by 7.8 percent from USD 1.56/USD in June 2008 to USD 1.43/USD in September.

In response to the heightened financial tensions, several central banks in Latin America have also taken a range of measures to improve liquidity conditions in their country.

Prices of non-energy commodities have also declined since the beginning of October. Metal prices have been especially hit by fears of a global recession. Most food commodities have been driven down by supply-side factors, with most harvests in the northern hemisphere displaying record yields. In aggregate terms, the price index for non-energy commodities (denominated in US dollars) was approximately 19% lower at the end of October than a year earlier.

Similarly, the US dollar showed an appreciation of 8.6 percent against the Pound Sterling during the same period. On the other hand, the US dollar slightly depreciated by 0.3% during the same period against the Japanese Yen.

11.5 Global Economic Impact on Ethiopian Economy

As the global economic slow down intensifies, its effects are increasingly felt in emerging and developing economies in addition to the advanced economies. The impact of the slow down on the Ethiopian economy has so far remained minimal. However, export earnings are likely to decline as commodity prices go down if the economic down turn persists. Remittances tourism and FDI inflows may also be affected to some extent.