I. OVERVIEW

The second quarter of 2008/09 witnessed a slowdown in quarterly headline inflation which stood at -4.4 percent, which is -25.4 percentage points higher than that of the preceding quarter, and -8.9 percentage points than that of same period last year. Similarly, the quarterly food inflation fall to -8.4 percent from 28.2 percent in the preceding quarter and 5.9 percent a year ago. The quarterly non-food or core inflation reached 4.1 percent, 3.5 percentage points less than that of the first quarter and 1.7 percentage points greater than that of the corresponding quarter of last year. This is due to higher inflation rate in house rent, construction materials, fuel, water and power; furniture, furnishing, household equipment and operation as well as beverages sub-categories of the CPI.

At the end of the second quarter, broad money supply reached Birr 75.9 billion, depicting a quarterly and annual growth rates of 6.3 and 24.1 percent, respectively. The yearly upsurge was wholly driven by an increase in domestic credit (26.6 percent), which was solely attributed to 51.9 percent expansion of credit to the non-government sector. The surge in domestic credit out weighed a 28 percent decline in net foreign assets (28.0 percent).

On the liability side, compared to that of same quarter last year, savings deposits went up by 23.7 percent, and demand deposits by 37.8 percent; whereas time deposits dropped by -20.6 percent. On quarterly basis, except time deposits, total deposits continued to grow. Reserve money also exhibited a significant annual increase of 38.1 percent owing to higher bank deposits at the central bank and currency in circulation.

Average nominal interest rate on savings deposit and government bonds remained at the same level of the preceding quarter; while that of time and demand deposits showed a marginal increase. Average bond yield also stood the same when compared to the previous quarter and same period last year. Yields on Treasury bills on average depicted improvements during the review period. At the same time, lending rate averaged 11.5 percent showing no change over the previous quarter and the first quarter of 2007/08.

Real interest rates on deposits and yields on T-bills and bonds remained negative owing to higher inflation.

Regarding financial institutions, the total number of banks in the country stood at the preceding quarter level. Some 28 new bank branches were opened during the review quarter, thus raising the total number to 596. However, Ethiopia still remains one of the under-banked countries in Sub-Saharan Africa as the people-to-bank ratio still remains high.

Not withstanding the unfavorable ratio, banks in the country have continued scaling up their resource mobilization and disbursement activities. Stock of deposits went up by 23.2 percent, loan collection by 40.3 percent and new loan disbursement by 10.1 percent on annual basis. The share of private banks in the total deposits rose to 35.5 percent compared to 32.8 percent a year ago. At the same time, of the total new loans disbursed, 69.8 percent was by private banks. As for the beneficiaries of the new loans, 55 percent went to finance trade, 15 percent housing and construction, 11 percent to industry and 8 percent to the agriculture sector.

On the other hand, the number of insurance companies reached 11 with 177 branches. The number of micro finance institutions (MFIs) also reached 28. Their contribution to poverty alleviation through their savings mobilization and credit allocation at grass roots level is . During the review period, MFIS mobilized Birr 1.8 billion in savings and their credit outstanding reached Birr 4.8 billion.

Activities in the financial market continued to be dominated by Treasury bills auctioned every 15 days. The amount of T-bills sold increased by 0.5 percent over the previous quarter, but were down by about 58 percent in contrast with a year ago. About 78 percent of the T-bills were sold to non-bank institutions. During the review period, average weighted yield on T-bills was 0.751 percent vis-à-vis 0.651 percent a quarter earlier but lower than a year ago.

External sector performance shows that export receipts reached USD 270.9 million, showing a marginal increase of 1.2 percent over last year same quarter. Foreign exchange earnings from coffee, the main export item, fell by 20.6 percent and 68.7 percent when compared to same period of last year and the previous quarter, respectively due to the decline both in price and volume. Revenue from pulses and leather and leather products also slowed down on annual basis owing to the same reasons. Meat and meat products, live animals, oilseeds, flowers, gold and *chat* depicted annual increases. Regarding direction of trade, about 38.4 percent of Ethiopia's exports were sent to Europe, 34.7 percent to Asia, 23.8 percent to other African countries and 2.7 percent to the Americas.

Similarly, import bills surged by 22.9 percent over that of last year same quarter and reached USD 1942.4 million as imports of all categories except fertilizer, fuel, and agricultural capital goods increased significantly. In the review quarter, fuel imports consumed USD 244.4 million (or 12.6 percent of the imports). The shares of capital goods, raw materials and semi-finished goods and consumer goods in the total quarterly import bills reached 29.5, 6.05, 12.6 and 36.9 percent, respectively.

As to the origin of imports, about 63 percent of the country's import items came from Asia, 24.7 percent from Europe, 8.3 percent from the Americas and 3.9 percent from Africa.

Meanwhile, net receipts from services reached to USD 170.3 million in contrast to USD 70.7 million a year earlier as receipts from travel, transportation and government increased. Net transfers also surged to USD 1,255.9 million from USD 938.1 million last year largely owing to significant growth both in private and public transfers. On the other hand, non-monetary capital increased to USD 416.3 million from USD 331.6 million a year ago due to increased loan disbursement and FDI inflows.

Although trade balance deficit widened due to improvements in net services, the current account deficit (including transfers) amounted to USD 245.3 million lower than USD 305 million last year same period. Consequently, the overall balance of payments registered a deficit of USD 43.9 million in contrast to a deficit of USD 140.5 million last year.

Regarding foreign exchange market, average exchange rate of the Birr in the official market showed a quarterly and annual depreciation of 2.1 and 8.8 percent, respectively and reached Birr 9.867 against USD. In the parallel market, its annual rate of depreciation stood at 14.4 percent. As a result, the premium between the two markets on average widened to 9.0 percent. On the other hand, the real effective exchange rate of the Birr tended to depreciate as inflation began to subside and the nominal exchange rate further depreciated. As compared to the previous quarter, it depreciated by 7.7 percent while it appreciated by 31.0 percent over same period of the preceding fiscal year.

As to Federal Government fiscal operations, the total revenue and grants stood at Birr 11,279 million which indicated an increase of 57.7 percent on annual basis. Tax revenue rose by 23.5 percent to Birr 6,652 million, while non-tax revenue surged by 113 percent to Birr 1,091 million. Similarly, total Federal Government expenditure reached Birr 9,790 million, about 0.5 percent higher than that of last year as both current and capital expenditures decreased while regional transfer rose by 26.5 percent. Hence, Federal Government overall fiscal operations resulted in an overall fiscal surplus (including grants) of Birr 1,489 million compared to Birr 2,588 million deficits a year earlier.

With regard to investment, a total of 1,966 projects with an aggregate capital of Birr 28.5 billion were licensed during the quarter under review, 12.7 percent higher than that of last year same period. Out of this, domestic investment accounted for 80 percent of the total projects approved in the quarter. Upon going operational, these projects are expected to create over 240,960 permanent and casual jobs. In terms of sectoral share, agriculture, hunting and forestry make up the major proportion (25.3 percent) of the total investment projects followed by manufacturing (21.2 percent), real estate development, renting and various business activities (16.8 percent), as well as hotels and restaurants (12.4 percent).