

## **X. INTERNATIONAL ECONOMIC DEVELOPMENT<sup>1/</sup>**

### **10.1 Overview of World Economy**

Although the latest indicators point to a slowdown in the pace of the global economic contraction, there is not as yet any concrete evidence of the start of a firm recovery.

In the United States, economic activity remained subdued. According to final estimates, real GDP contracted by 5.5% in annualised terms in the first quarter of 2009, after 6.3% in the preceding quarter. Exports and inventories, as well as private fixed investment, continued to be a drag on the economy in the first quarter of 2009, which was only partly compensated for by lower imports and relatively robust consumer spending.

Real GDP growth in Japan showed a quarter on quarter fall of 3.8% in the first quarter of 2009. This is the biggest contraction on record and marks the fourth consecutive quarter of negative quarterly growth. The weak first-quarter performance was due to the sharp

quarter-on-quarter fall in exports (-26%), private investment (-8.9%), housing investment (-5.5%) and consumption (-1.1%).

The pace of economic activity in the euro area declined markedly in early 2009 following a protracted contraction in both domestic and world demand. According to preliminary estimates, euro area real GDP showed a quarter on quarter contraction of 2.5% in the first quarter of 2009, following a 1.8% decline in the last quarter of 2008.

In the United Kingdom, real GDP decreased by 2.4% quarter-on-quarter in the first quarter of 2009. The decline was broad based among expenditure components. Looking ahead, real GDP is expected to shrink further, as falling employment, lower housing and financial wealth, and tight credit conditions are likely to continue to weigh on consumer spending in the near term.

According to the latest monthly indicators, the pace of decline in economic activity slowed considerably in most emerging Asian economies in the second quarter of 2009. In particular, the most recent trade data point to positive monthly changes in several countries, thus suggesting that the collapse of trade that has affected the region so severely may be coming to an end. Although the lagged negative effects of the global crisis, such as rising unemployment, are holding back domestic private demand, there are clear signs that a recovery is already in progress in the largest economies.

In China, monthly indicators show that economic growth was relatively robust in the second quarter of 2009. Although growth is still very much dependent on fiscal stimuli, mainly via public investment, available data suggest that private consumption growth, too, has been surprisingly resilient. The outlook for the real estate market seems to have started to improve slightly, with investment again growing in this sector.

In Latin America, the pace of economic activity remained weak in the first

quarter of 2009. In Brazil, real GDP contracted by 1.6% on an annual basis in the first quarter of 2009. The contraction was most pronounced in exports and investment. In Argentina, real GDP expanded by 2.6% on an annual basis in the first quarter of 2009. In Mexico, industrial production fell by 9.2% compared with a year earlier.

## **10.2 Inflationary Developments**

Global inflation rates have been diminishing rapidly in recent months. This was due both to rising spare capacity (as a result of the downturn in global economic activity) and to negative base effects from last year's increases in commodity prices.

Annual CPI inflation in the US decreased substantially, falling to -1.3% in the year to May 2009, from -0.7% in April. The decline was driven by base effects linked to energy prices. The annual rate of inflation excluding food and energy decreased to 1.8% in May, from 1.9% in April.

In Japan, annual CPI inflation declined sharply to -1.1% in May 2009, compared

with -0.1% in April, reflecting base effects related to energy costs and increasing economic slack. CPI inflation excluding food and energy also declined to -0.5% on an annual basis in May, from -0.4% in April.

Euro area annual HICP inflation dropped from 0% in May to -0.1% in June, its first negative value since the start of EMU

Following a slight increase at the beginning of 2009, possibly reflecting a larger than-expected pass-through of exchange rate depreciation to consumer prices, annual HICP inflation in the UK again declined to 2.2% in May, down from 2.3% in April.

Consumer price inflation has continued to decline in emerging Asia, even entering into negative territory in some countries. In China, CPI inflation remained negative in May at -1.4% year on year, after -1.5% in April.

Inflationary pressures were easing in Latin American countries, albeit only gradually. In Brazil, annual inflation stood at 5.4% in May while it decreased slightly to 5.5% in Argentina. In

Mexico, annual inflation declined to 6.0% in May compared with 6.2% in April.

As inflation has been low and economic activity has continued to slow down, monetary policy stance of central banks around the world has been loose. On 24 June, the US Federal Open Market Committee (FOMC) decided to keep the target for the policy rate unchanged at a range of 0% to 0.25%. The Fed has also continued its use of unconventional measures in an effort to support financial markets and stimulate the economy. Similarly, the Bank of Japan decided to keep its target for the uncollateralised overnight rate at around 0.1% on 16 June.

At its meeting on 2 July 2009, the Governing Council of the European Central Bank also decided to leave the key interest rates unchanged. On 4 June 2009 the Monetary Policy Committee of the Bank of England announced its decision to maintain the official Bank Rate paid on commercial bank reserves at 0.5% and to continue the policy of quantitative easing for two more months, providing for additional purchases to

bring the scale of its programme of asset purchases to a total of GBP 125 billion.

Central banks in emerging economies have also been moving along the same line. The accommodative monetary policy and the fiscal stimulus in China have been reflected in very fast credit growth figures. At the end of May, the stock of loans outstanding was 30% larger than a year earlier.

On 11 June the Banco Central do Brazil lowered its key interest rate by 100 basis points to 9.25% while the Banco de México lowered its key interest rate by 50 basis points to 4.75% on 19 June.

### **10.3 Commodity Markets**

After showing a declining trend at the start of the year, oil prices posted a strong recovery starting in May. Prices of Brent crude oil stood at USD 70.1 per barrel on 1 July, which was 77% higher than at the beginning of 2009. Looking ahead, market participants expect higher prices over the medium term, with futures contracts for December 2011 trading at around USD 79 per barrel.

Recently, oil prices have been sustained by less pessimistic market expectations about the global macroeconomic environment. Looking at the underlying fundamentals, OPEC countries indeed showed an unusually high degree of compliance with the agreed cuts, and global oil production has fallen massively in recent months, totalling around 3.36 million barrels per day less than a year before.

The prices of non-energy commodities have generally increased over the past months. Metal prices rose in June, having been relatively stable over the previous two months. Agricultural commodity prices increased as well, driven by prices of soybeans in particular, which have been influenced by social unrest in Latin America and weather-related effects in India. In aggregate terms, the index for non-energy commodity prices (denominated in US dollars) was approximately 18% higher in mid-June than at the beginning of the year.

### **10.4 Exchange Rate Developments**

After showing appreciating trends during the latter part of 2008 and the first few months of 2009, the US dollar again began to show depreciating trends against major currencies towards the second half of the year. The average exchange rate of the US dollar against the Euro which was 1.30 in March 2009 depreciated to 1.40 in June 2009. Similarly, the US dollar-Pound Sterling exchange rate depreciated from 1.42 to 1.64 over the same period.

On the other hand, the Japanese yen which was gaining strength against the US dollar at the end of 2008 and in the first two months of 2009 became relatively weaker towards the middle of the year. The yen-dollar exchange rate depreciated from 92.92 in February 2009 to 96.61 in June 2009.

#### **10.5 Impact of Global Economic Developments on Ethiopian Economy**

The effect of the global economic crisis began to show negative impacts on Ethiopia's export trade towards the end of the 2008/09 fiscal year. Export

earnings which used to grow by an annual average rate of about 20 percent over the past few years grew by just 1.6 percent during the first nine months of 2008/09. Declines in the international prices of major export items following the global economic crisis contributed to this slow down in export earnings although other domestic and external factors also played some role. Meanwhile, remittance inflows continued to grow showing an annual increase of 10.6 percent during the first nine months of the fiscal year.

On the other hand, the decline in global commodity prices which accompanied the global economic downturn is contributing to easing of the balance of payments problems by reducing the country's foreign exchange payments. For example, according to information obtained from the Ethiopian Petroleum Enterprise, petroleum imports of the country during the first nine months of 2008/09 was 7.2 percent lower than the amount imported during the same quarter last year.