I. OVERVIEW

During the third quarter of 2008/09, quarterly headline inflation continued to depict a downward trend to reach -4.2 percent, though 0.2 and 12.2 percentage points higher than the preceding quarter and that of same period last year, respectively. The quarterly food inflation increased to 7.3 percent from -8.4 percent in the preceding quarter but still lower than the 9.3 percent level a year ago. Meanwhile, the quarterly non-food or core inflation reached 1.5 percent, 2.6 percentage points less than that of the second quarter and 4.5 percentage points greater than that of the corresponding quarter of last year.

At the end of the third quarter, broad money supply reached Birr 80.6 billion, depicting a quarterly and annual growth rate of 6.2 and 22.6 percent, respectively. The yearly upsurge was driven by an increase in domestic credit (16.1 percent), which was solely attributed to the 30.8 percent expansion of credit to the non-government sector offsetting the decline in credit to the government, and 12.1 percent annual increase in net foreign assets. The quarterly growth in broad money supply was entirely ascribed to the surge in net foreign assets, which outweighed a decline in domestic credit.

On the liability side, compared to that of same quarter last year, savings deposits went up by 24.4 percent, and demand deposits by 34.5 percent; whereas time deposits dropped by 16.5 percent. On quarterly basis, all types of deposits continued to grow. Reserve money also exhibited a significant annual increase of 38.2 percent owing to higher bank deposits at the central bank and currency in circulation.

Average nominal interest rate on savings deposit and demand deposits showed a marginal increase; while weighted time deposit rate indicated a slight decline. Weighted average yield on Treasury bills also depicted improvements during the review period. At the same time, average lending rate reached 12.25 percent from its level of 11.5 percent in the previous quarter. Real interest rates on deposits and yields on T-bills and bonds remained negative during the review quarter owing to higher inflation.

Regarding financial institutions, the total number of banks in the country stood at the preceding quarter level of 13 Some 21 new bank branches were launched during the review quarter, thus raising the total number to 617. However, Ethiopia still remains one of the under-banked countries in Sub-Saharan Africa as the people-to-bank ratio still remains high with are branch serving over 130,000 people.

Despite the unfavorable ratio, banks in the country have continued boosting their resource mobilization and disbursement activities. Stock of deposits went up by 24.2 percent, loan collection by 17.2 percent; while disbursement of new loan declined by 30.0 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. Of the total new loans disbursed, 63.8 percent was provided by private banks. As to the beneficiaries of the new loans, 50.7 percent went to finance trade, 20.3 percent to housing and construction, 12 percent to industry and 6 percent to the agriculture sector.

On the other hand, the number of insurance companies reached 12 with 190 branches. Except one, all are privately owned.

The number of micro finance institutions (MFIs) stood at 28. During the review period, these institutions mobilized Birr 1.9 billion in savings; while their credit outstanding stood at Birr 4.6 billion. Their total assets have also increased during the stated period.

Activities in the financial market continued to be dominated by Treasury bills auctioned every 15 days. The amount of T-bills sold decreased by 15.6 and 39.2 percent against that of the previous quarter and same period last year, respectively. All the T-bills were sold to non-bank institutions. During the review period, average weighted yield on T-bills was 0.661 percent vis-à-vis 0.751 percent a quarter earlier, but still higher than a year ago.

Year-on-year basis, external sector performance showed declines both in exports and imports. Export receipts reached USD 401.6 million, showing a 15 percent drop in foreign exchange earnings from coffee – the main export item. Receipts from leather and leather products, pulses, fruits and vegetables also went down while revenue from oilseeds, flower, gold and *chat* as well as live animals. A fall in revenue from coffee is attributed to the decrease in its volume of export (partly due to marketing problems) and decline in international prices. Regarding the direction of trade, about 39.8 percent of Ethiopia's exports was shipped to Asia, 39.6 percent to Europe, 15.5 percent to various African countries and 4.6 percent to the Americas.

On the other hand, import bills declined by 2.7 percent over that of last year same quarter and reached USD 1.7 billion as imports of semi-finished goods and fuel registered a significant decline. In the review quarter, fuel imports consumed USD 220.0 million (or 12.8 percent) of the quarterly imports. Meanwhile, imports of capital goods, raw materials and consumer goods depicted substantial increase year on-year basis. Accordingly, the shares of capital goods, raw materials, semi-finished goods and consumer goods in the total quarterly import bills were 34.5, 4.5, 16.05 and 30.7 percent, respectively. About 68.7 percent of the country's import items have their origin from Asia, 22.8 percent from Europe, 4.1 percent from the Americas and 4.3 percent from Africa.

In the meantime, net receipts from services reached USD 103.4 million up by 74.7 percent as a result of the surge in net receipts from travel, transportation and government services. Net transfers also declined to USD 963.5 million from USD 1292.7 million in the preceding quarter owing to significant decline in net official transfers.

Even though trade balance deficit narrowed, the current account deficit (including transfers) widened by 20 percent to reach USD 254.7 compared to the previous quarter due to the decline in the official transfers; however it narrowed by 25.6 percent compared to its level a year ago. Consequently, the overall balance of payments registered a surplus of USD 309.9 million in contrast to a deficit of USD 43.9 million in the previous quarter and USD175 million last year.

Regarding foreign exchange market, average exchange rate of the Birr in the official market showed a quarterly and annual depreciation of 11.0 and 17.5 percent, respectively and reached Birr 10.9521 per USD. In the parallel market, its quarterly and annual rate of depreciation was 19.2 and 28.4 percent, respectively. As a result, the premium between the two markets on average widened to 17.0 percent. On the other hand, the real effective exchange rate of the Birr continued to depreciate as inflation began to subside and the nominal exchange rate further depreciated. As compared to the previous quarter, it depreciated by 13.9 percent although it appreciated by 13.8 percent over same period of the preceding fiscal year.

As to Federal Government fiscal operations, the total revenue and grants stood at Birr 7,188 million indicating 36.3 and 15.8 percent decline on quarterly and annual basis, respectively. Tax revenue declined by 19.4 percent to Birr 5,359 million, while non-tax revenue surged by 61.9 percent to Birr 1,768 million compared to the previous quarter. Similarly, total Federal Government expenditure increased by 25 and 56 percent on quarterly and annual basis to reach Birr 12.2 billion, due to the significant increase in capital expenditure. Hence, Federal Government overall fiscal operations resulted in an overall fiscal deficit (including grants) of Birr 5.05 billion compared to a surplus of Birr 1,478 million in the preceding quarter.

With regard to investment, a total of 1,761 projects with an aggregate capital of Birr 28.4 billion were licensed during the quarter under review, 16 percent below that of last year same period. Out of this, domestic investment accounted for 79.5 percent of the total private investment projects approved in the quarter. Upon going operational, these projects are expected to create over 266,728 permanent and casual jobs. In terms of sectoral share, the manufacturing sector make up the major proportion (25.4 percent) of the total investment projects followed by agriculture, hunting and forestry (19.7 percent), real estate development, renting and various business activities (17.6 percent), as well as construction (12.8 percent).

Basic performance indications for the manufacturing sector showed that the number of manufacturing firms remained at 910, while total employment in the sector declined by about 6 percent compared to last year same quarter. Their average capacity utilization was only 50.4 percent indicating lack of demand, shortage of water and electricity, insufficient raw materials or inputs as well as shortage of capital. At the same time, micro and small-scale enterprises are playing significant role towards reducing urban unemployment.

All in all, year-on-year terms the third quarter of 2008/09 was characterized by moderate inflation, monetary expansion, stable interest rate, improving resource mobilization by the banking system, widening current account deficit but a surplus in the overall balance of payments, continued depreciation of the nominal and real effective exchange rates of the Birr, large fiscal deficit and lower licensed investment projects.