

X. INTERNATIONAL ECONOMIC DEVELOPMENT^{1/}

10.1 Overview of World

Economy

Latest indicators are increasingly suggesting that the significant contraction in economic activity has come to an end, notably in major emerging economies as well as in a number of advanced economies.

In the United States, economic activity appears to have stabilised. According to revised estimates, real GDP contracted by 0.7% in annualised terms in the second quarter of 2009, less than previously estimated. The contraction in the second quarter, which follows a much more pronounced fall of 6.4% in the first quarter, was mostly due to negative contributions from inventory investment, private fixed investment and private consumption. Government expenditure and decreasing imports contributed positively to growth in the second quarter. Looking ahead, the

outlook for GDP growth has been improving recently. While financing conditions remain tight and labour markets weak, recent data point to improvements in the housing market and the manufacturing sector. Moreover, government stimulus measures continue to provide substantial support to the economy.

In Japan, economic activity started to recover in the second quarter of 2009. According to preliminary estimates, real GDP grew by 0.6% quarter on quarter in the second quarter of 2009. This is less than previously estimated and compares with a decline of 3.3% in the previous quarter. The recovery stems primarily from higher net exports.

The pace of the decline in euro area activity slowed markedly in the second quarter of 2009. According to latest estimates, euro area real GDP contracted by 0.2% (quarter on quarter) in the second quarter of 2009, after a decline of 2.5% in the first quarter of 2009.

^{1/} Sections 6.1-6.3 are excerpts from European Central Bank, Monthly Bulletin, October 2009

In the United Kingdom, the decline in real GDP moderated in the second quarter of 2009, reaching -0.6% quarter on quarter compared with -2.5% in the first quarter. Private consumption and gross fixed capital formation continued to contribute negatively to GDP growth, though less so than in the first quarter, whereas government consumption, net exports, and especially inventory accumulation contributed positively. Short-term indicators suggest a further improvement in economic activity in the third quarter.

The recovery has continued in emerging Asia, even though its pace seems to have slowed down slightly in some economies recently. While fiscal stimuli, accommodative monetary policy and higher asset prices have supported domestic demand, the recovery of foreign trade has been considerably slower. Both imports and exports are clearly below the levels prevailing in the summer of 2008.

In China, monthly indicators suggest that economic growth remained robust in the third quarter of 2009. Although growth

was largely dependent on the fiscal stimulus and the resulting boost in infrastructure investment, growth in private investment also accelerated, mainly owing to the improved outlook in the real estate sector. While investment growth increased commodity imports in China, the recovery of exports has been much slower. Accommodative monetary policy and the fiscal stimulus have been reflected in heightened credit growth. In August 2009 the loan stock was 33% larger than a year earlier.

While the overall economic situation in Latin America has been improving, there has been some heterogeneity in the growth performance of major economies. In Brazil, economic activity recovered notably in the second quarter, with real GDP increasing by 1.9% compared with the previous quarter. In Argentina, real GDP expanded by 1.1% year on year in the second quarter, down from 2.6% in the first quarter. In Mexico, activity appears to have reached an inflection point following the sharp contraction during the first half of the year. Industrial production decreased in July by 7% year on year, after having

fallen at double-digit rates in the two previous months.

10.2. Inflation Developments

Global inflation rates remain low, owing to base effects related to commodity prices and substantial spare capacity. In the United States, consumer price index declined by 1.5% in the year to August 2009. This followed a decrease of 2.1% in the year to July. The negative headline inflation continues to be driven, for the most part, by the decline in energy prices compared with the previous year. The annual rate of inflation, excluding food and energy, reached 1.4% in August, down from 1.5% in July. Looking ahead, base effects related to energy prices will be gradually reversed over the months to come and headline inflation rates are likely to return to positive territory. However, economic slack is expected to limit the upward pressure on prices.

Annual CPI inflation remained negative in Japan at -2.2% in August, unchanged from July. This reflects the output gap and base effects stemming from last year's rise in energy prices. Annual CPI inflation, excluding food and energy,

also remained unchanged at -0.9% in August.

According to preliminary estimates, euro area annual HICP¹ inflation reached -0.3% in September, down from -0.2% in August driven mostly by a stronger than expected fall in the annual rate of change in energy prices

Annual HICP inflation decreased to 1.6% in August in the United Kingdom and the Bank of England expects inflation to remain below its 2% target in the near term.

Annual changes in consumer prices were still in negative territory in a number of countries in emerging Asia. However, recent data point to a gradual return to positive inflation rates. In China, annual changes in consumer prices have continued to be negative, although the pace of decline slowed from -1.8% in July to -1.2% in August.

Inflationary pressures have continued to recede in most economies in Latin America. In August annual consumer price inflation fell to 4.3% in Brazil,

¹ Harmonized Index of Consumer Prices

compared with 4.5% in July. On the other hand, annual consumer price inflation increased to 5.9% in August in Argentina. Inflationary pressures declined further in Mexico, with annual consumer price inflation reaching 5.1% in August, down from 5.4% in July.

Despite the signs of recovery in global economic conditions, there was no change in the monetary policy stance of major central banks in the world. On 23 September 2009 the US Federal Open Market Committee (FOMC) decided to keep its target for the federal funds rate unchanged within a range of 0% to 0.25%. Similarly, the Bank of Japan decided to leave its target for the uncollateralised overnight call rate unchanged at 0.1% at its meeting on 17 September 2009.

The Governing Council of the European Central Bank decided to leave the key ECB interest rates unchanged at its meeting on 8 October 2009 while the Monetary Policy Committee of the Bank of England also decided to maintain the official Bank Rate paid on commercial bank reserves at 0.5% on 10 September. Furthermore, the Bank of England

continued with the GBP 175 billion asset purchase programme.

10.3 Commodity Markets

Oil prices remained broadly stable in September and early October. On 7 October Brent crude oil prices stood at USD 68.9 per barrel (which is 74% higher than at the beginning of 2009). Looking ahead, market participants expect higher oil prices in the medium term, with futures contracts for December 2011 trading at around USD 78.

The prices of non-energy commodities also remained broadly stable in September. After having moderated substantially in the past few months, food prices posted some increases, led by maize, which was affected by adverse weather conditions in the US Midwest. By contrast, metal prices moderated amid market concerns that the restocking process in China that has supported demand in recent months may have come to an end. In aggregate terms, the price index for non-energy commodities (denominated in US dollars) was about 19% higher at the end of September than at the beginning of the year.

Coffee prices showed increasing trends through out 2009 after drastically falling towards the end of 2008 from their very high levels. In September 2009, the International Coffee Organization's composite indicator price was 116.4 US cents per pound which was about 7.4 percent higher than its level at the beginning of the year. However, coffee prices were showing declining trends on year-on-year basis through out 2009.

10.4 Exchange Rate Developments

The US dollar has been weak against all major currencies through out 2009. It showed continuous depreciation trends against the Euro its average rate reaching USD 1.45/Euro in September 2009 compared to USD 1.32/Euro in January. Similarly, its average exchange rate against the Pound Sterling also depreciated from USD 1.45/Pound in January 2009 to USD 1.63/Pound in September.

After falling to very low levels during the first months of 2009, the Yen-US dollar exchange rate showed upward trends towards the end of the first half of

the year before falling again. In September 2009, the average Yen-US dollar exchange rate was 91.27, slightly up from its level of 90.12 in January but down from 96.61 in June.

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 declined by 1.2 percent during 2008/09. Declines in the international prices of major export items following the global economic crisis contributed to this decline in export earnings although other domestic and external factors also played some role. Similarly, remittance transfers which were showing significant rate of growth during the past couple of years declined by 9.6 percent primarily due to the global economic recession.

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 2008/09 were 25.1 percent lower than the amount imported during the preceding fiscal year.