

IX. INTERNATIONAL ECONOMIC DEVELOPMENTS

9.1. Overview of World Economy/ 1

1/ Excerpted from European Central Bank Monthly Bulletin, November, 2009.

Latest indicators reinforce the view that the significant contraction in global economic activity has come to an end and that the world economy has started growing again. In October, the global Purchasing Managers' Index (PMI) of output in the manufacturing sector recorded the highest value in more than three years and signaled that activity had picked up at a significantly higher pace than in previous months. According to the PMI, global activity in the manufacturing sector has expanded for five consecutive months. The expansion in activity in October was rather broad-based and was particularly strong in a number of advanced economies.

In the United States, economic activity expanded in the third quarter of 2009 after the sharp downturn in the previous

quarters. According to advance estimates by the Bureau of Economic Analysis, real GDP increased by 3.5% in annualized terms in the third quarter of 2009, following four quarters of negative growth. The pick-up in activity reflects gains in consumer spending. Government stimulus measures temporarily supported private demand, particularly for motor vehicle sales. The pace of decline in business investment moderated from the previous quarter, while residential investment posted its first increase since late 2005, in line with recent signs of stabilization in housing markets. Inventories and government expenditure contributed positively to GDP growth. Net trade recorded a negative contribution of 0.5 percentage point as the rebound in imports outweighed the rise in exports.

In Japan, economic activity has recovered since the second quarter of

2009. The recovery has mainly been driven by an upturn in exports, reflecting, in part, the strong recovery in other Asian economies. In September, industrial production rose for a seventh consecutive month, by 1.4% month on month. Domestic private demand, however, has remained relatively weak in the light of subdued developments in corporate profits, employment and income.

According to preliminary estimates, real GDP in the United Kingdom, contracted slightly further in the third quarter, by 0.4% quarter on quarter, following the decline of 0.6% in the second quarter. Economic activity in the third quarter was significantly below market expectations. Overall, activity and housing market indicators suggest that the economic situation may improve in the months ahead. In particular, the Halifax house price index grew by 2.8% quarter on quarter in the third quarter, in spite of weak mortgage lending. At the same time, however, renewed weakness in industrial production – evidenced by the 2.5% decline month on month in August – suggests that the improvement in the economic situation might be rather limited.

The recovery has continued in emerging Asia. In addition to fiscal stimuli and accommodative monetary policy, higher asset prices have supported domestic demand. The most recent labor market data indicate that unemployment – which had risen in the wake of the global slowdown – has begun to decline in some countries. The rebound in foreign trade, however, has been lagging behind the economic recovery. In China, annual real GDP growth remained robust, accelerating to 8.9% in the third quarter of 2009. Overall, in the first three quarters of 2009, GDP increased at an average rate of 7.7% year on year. Growth continued to be largely dependent on the fiscal stimulus, with stimulus-driven fixed investment contributing 7.3 percentage points to annual GDP growth in the first three quarters of 2009. The contribution from consumption remained robust at 4.0 percentage points over the same period. Owing to weak exports, the trade surplus continued to decline in September, 2009.

In Latin America, the latest developments in economic activity have remained heterogeneous across the major economies. In Brazil, industrial

production declined at an annual rate of 7.8% in September, after falling by 7.2% in August. In Argentina, economic activity showed some signs of improvement, with industrial production remaining unchanged in September compared with a year ago, following a decline of 1.4% year on year in August. Economic activity in Mexico showed renewed signs of weakness in August, with industrial production declining by 7.7% year on year.

9.2. Inflation Developments

Global inflation rates have remained slightly negative owing to base effects related to commodity prices and elevated spare capacity. The headline CPI in OECD countries fell by 0.3% in the year to September, the same rate as in August. Excluding food and energy, annual CPI inflation was 1.5% in September. The global PMI of manufacturing input prices highlighted marked increases in global purchasing prices in October, following the acceleration recorded in September, partly owing to the recent increases in commodity prices.

The US consumer price index declined by 1.3% in the year to September. This followed a decrease of 1.5% in the year to August. 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, stood at 1.5% in September, up from 1.4% in August.

Annual Harmonized Index of Consumer Price (HICP) inflation in UK decreased from 1.6% in August to 1.1% in September. On 5 November the Monetary Policy Committee decided to maintain the official Bank Rate paid on commercial bank reserves at 0.5%. The Committee also decided to increase the size of the Bank of England's asset purchase program by GBP 25 billion to GBP 200 billion.

Inflation rates have remained negative in Japan over recent months owing to base effects related to petroleum products and considerable economic slack. While annual CPI inflation remained unchanged at -2.2% in September; annual CPI inflation excluding food and energy fell to -1.0% from -0.9% in

August. At its meeting on 30 October 2009, the Bank of Japan decided to leave its target for the uncollateralized overnight call rate unchanged at 0.1%.

According to Eurostat's flash estimate, Euro area annual HICP inflation stood at -0.1% in October, up from -0.3% in September. The current slightly negative inflation rates are in line with previous expectations and reflect mainly movements in global commodity prices over the past year. The fluctuation in annual HICP inflation rates in recent months largely responds to the interaction of upward base effects stemming from the drop in these prices in the second half of 2008 with current movements in global commodity prices. As in previous months, the contribution of the energy price component to overall annual HICP developments was particularly negative. The annual rate of change in the energy component of the HICP decreased to -11.0% in September from -10.2% in August despite a small upward base effect stemming from the decline in oil prices 12 months earlier. Falling prices of liquid fuels for transport and heating were the main drivers of a significant month-on-month

decrease in energy prices, while the annual growth rates of electricity and gas prices continued to decline following last year's developments in oil prices with a lag.

Inflation is gradually picking up, even though annual changes in consumer prices are still negative in some of emerging Asia countries. Recently, monthly changes in consumer prices in China have become positive and annual inflation reached -0.8% in September, up from -1.2% in August.

Annual CPI inflation in Brazil stood at 4.2% in September, 0.1 percentage point lower than in the previous month. In Argentina, inflationary pressures have picked up somewhat, with annual CPI inflation reaching 6.2% in September, up almost 1.0 percentage point from the five-year low recorded in June. Annual inflation in Mexico declined somewhat from 5.1% in August to 4.9% in September.

9.3. Commodity Prices

Oil prices were between USD 70 and USD 75 per barrel for most of October before posting a notable increase

towards the end of the month. Looking at fundamentals, oil demand is expected to increase and the International Energy Agency has repeatedly revised its 2009 and 2010 demand projections upwards, especially for North America and Asia. Chinese trade data also point to robust growth in oil demand, which may have added momentum to rising prices. On the supply side, a moderate decrease in non-OPEC oil production was offset by increased output by OPEC countries.

The prices of non-energy commodities also increased in October. Food prices posted some increases, led, in particular, by maize and cocoa prices. Metal prices, especially copper and zinc, rose based on expectations of restocking taking place in OECD countries and gold prices also surged. In aggregate terms, the price index for non-energy commodities was about 23% higher at the end of October than at the beginning of the year.

9.4. Exchange Rate Developments

The euro exchange rate has continued to strengthen in nominal effective terms over the past three months, reaching levels close to its 2008 peak. On November 4, the nominal effective exchange rate of the euro was 2.6%

stronger than at the end of July and 2.7% stronger than its average 2008 level. Over the last three months the appreciation has primarily been driven by the developments in the bilateral euro rates vis-à-vis the US dollar, the pound sterling and the major Asian currencies linked to the US dollar.

While in August the USD/EUR exchange rate remained broadly stable, in September and most of October the euro strengthened again vis-à-vis the US dollar. This reflected a rather broad-based depreciation of the US dollar against a larger set of currencies, reportedly as a result of the low US interest rates and declining global risk perceptions. Over the last three months the implied volatility of the USD/EUR exchange rate has remained at close to its average value over the past ten years.

Over the last three months, the bilateral exchange rate of the euro vis-à-vis the Japanese yen has fluctuated between JPY 130 and JPY 138. It has reportedly been affected by changes in the overall risk perception in financial markets and market considerations regarding Japanese exchange rate policy. In the same period, the implied volatility of the

JPY/EUR exchange rate has continued to decrease, but has remained above its historical average.

A US dollar was trading at average of Birr 12.3746; depicting depreciation of the Birr against USD by 28.1 percent on annual basis in the first quarter of 2009/10. Similarly the Birr depreciated by 21.6, 11 and 47 percent against Euro, Pound Sterling and Yen respectively in the same period.

9.5. Impact of Global Economic Developments on Ethiopian's Economy

Global economic crisis has exerted marginal impact on Ethiopia's export trade. Export earnings from merchandise goods declined by 2.6 percent during the first quarter of 2009/10 vis-à-vis the same period last year due to lower international prices of major export commodities such as coffee, leather and leather products, pulses and oilseeds. Similarly, private transfers dropped by about 7 percent due to the lagged effect of global economic down turn which is beginning to show a sign of recovery, recently. With inceased efforts there is