I. OVERVIEW

1.1. International Economic Developments

The world economy has started to show a gradual revival after a two year long (2008-09) contraction. The economic recovery witnessed in advanced and emerging economies is manifested by a slight increase in economic growth, decline in unemployment, rise in manufacturing output and growth in export, partly due to increase in demand, among others.

Moreover, global inflation (excluding energy and food) is gradually picking up though annual change in consumer prices still remains negative in some parts of Asian countries. Oil prices which were between USD 70 and USD 75 per barrel in the month of October 2009 are expected to increase as a result of surge in international oil demand.

Despite the global economic recovery, the crisis has a mixed effect in the Ethiopian economy. On negative side, export of goods declined by 2.6 percent relative to a year ago. Remittance inflows, although showed 26 percent increase on quarterly basis, declined by 8.5 percent annually. On positive side, the country's BOP has tended to improve as a result of lower import payments particularly oil due to slow down in global commodity prices. Yet, revival of global economic growth is expected to boost Ethiopia's export performance, remittance transfers, FDI and tourism.

1.2. Performance of the Ethiopian Economy

The Ethiopian economy is estimated to have exhibited a 9.9 percent growth in 2008/09 and projected to expand by 10.1 percent in 2009/10 with envisaged broad-based growth in all sectors. Agriculture is expected to grow 6 percent, industry 10.2 percent and services14.5 percent in 2009/10.

The first quarter of 2009/10 depicted slow down in inflationary pressures. Headline inflation declined to 3.1 percent in the review period from 20.9 percent a year ago largely due to 26.6 percent deceleration in food inflation and 2.1 percent drop in non-food inflation. The subdued global inflation coupled with prudent fiscal and monetary policy measures taken by the government have contributed to this effect.

Broad money supply (M_2) showed quarterly and annual growth rates of 5.6 and 22 percent, respectively to reach Birr 87.2 billion in the review quarter, on account of substantial increase in net foreign assets and marginal expansion in net domestic credit, particularly credit to non-government sectors. Net foreign assets stood at Birr 22.1 billion, showing about 22.8 percent quarterly and 112.5 percent annual surges. Net domestic credit grew by 3.1 and 9.4 percent to Birr 92 billion, of which Birr 59.5 billion or 65 percent was extended to private sector.

Reserve money increased by 4 percent to Birr 46.9 billion relative to preceding quarter, due to a 13.4 percent rise in commercial banks' deposit at NBE, offsetting the 4.5 percent slow down in currency in circulation. Year-on-year basis, however, reserve money went up by 31 percent as currency in circulation and banks' deposit at NBE increased.

Regarding interest rate, the average saving deposit rate and lending rates remained unchanged from their respective levels of 4.5 and 12.3 percent at the end of June 2009 while the weighted average demand deposit and average time deposit rates depicted a quarterly increase of 22.8 and 0.9 percent. Weighted average yield on T-bills also increased to 0.803 percent from 0.646 percent a year ago. Yet, average bond yield remained at 4.5 percent.

Concerning financial sector development, the number of banks operating in the country increased by 1 to 14 while the number of insurance companies remained at 12 as it was in the previous quarter. In terms of branch expansion, 20 new bank branches and 2 new insurance branches were opened in the stated period by private banks and private insurance companies which raised the total number of bank and insurance branches to 656 and 196, respectively. On the other hand, the number of microfinance institutions remained at 28 but the total amount of outstanding credit extended to beneficiaries rose by 2 percent to Birr 5 billion relative to end June 2009.

Total resource mobilized by the banking sector rose by 24.9 percent to Birr 12.9 billion in the stated period against a year ago. The annual growth was on account of increase in net deposits, net borrowing and collection of loan by 42.2, 142.8 and 7.8 percent, respectively. Disbursement of fresh loans also increased by 11.7 percent to Birr 6.3 billion.

In the foreign exchange market, the exchange rate of Birr against USD was Birr 12.37 /USD, about 10.5 and 28 percent weaker compared to a quarter before and a year earlier, respectively. Meanwhile, the exchange rate of Birr against USD in the parallel market reached 13.29. Hence, the spread between official and parallel market rates narrowed to 7.4 percent from 19.7 percent in preceding quarter due to a 10 percent depreciation of the Birr in August 2009.

With respect to external sector development, quarterly export proceeds reached USD 342.4 million, about 2.6 percent lower than last year. The decline was attributed to a fall in earnings from coffee (21.4 percent), oilseeds (3.0 percent), leather and leather products (55.7 percent), meat and meat products (14.4 percent) and fruits and vegetables (35.9 percent). Similarly, imports decreased by 22.0 percent to USD 1.77 billion due to slow down in imports of fuel (47 percent), raw materials (37.5percent), capital goods (15.7 percent) and consumer goods (18.1 percent) compared to last year same quarter. Hence, merchandise trade deficit was USD 1.43 billion, about 25.5 percent lower than a year ago.

Total net transfers rose 6.9 percent to USD 1.04 billion from USD 969.1 million last year, owing to 40.4 percent increase in official transfers offsetting 6.8 percent decrease in private transfers. Services account also exhibited a surplus of USD 119 million in contrast to deficit of USD 163 million a year earlier.

Hence, the current account balance including public transfers, depicted a deficit of USD 277 million compared to USD 810 million last year. The capital account also registered a surplus of USD 409 million, resulting in USD 173.7 million BoP surplus, vis-a-vis USD 132.3 million deficit in the previous year.

The government fiscal operations witnessed 13.3 percent annual increase in total revenue including grants to Birr 10.16 billion and 24 percent rise in total expenditure to Birr 12.63 billion resulting in Birr 2.47 billion deficit (including grants), slightly wider than last year. The deficit was financed by external funds, privatization proceeds and others and residuals, while the government repaid Birr 898.5 million to domestic sources.