VII. INTERNATIONAL ECONOMIC DEVELOPMENTS

7.1. Overview of World Economy

The global economy continued to expand in the first quarter of 2010 and short-term indicators point to robust growth in the beginning of the second quarter. The recovery remains supported by the effects of monetary and fiscal policy stimuli and a prolonged inventory cycle. These positive developments in global economic activity have been accompanied by a further recovery in world trade.

In the United States, the economy remains on a recovery path. Having turned positive in the second half of 2009, real GDP growth gained further traction in early 2010. According to the second estimate by the Bureau of Economic Analysis, real GDP increased by 3.0% in annualized terms in the first quarter of 2010, following a 5.6% increase in the last quarter of 2009. The economic expansion in the first three months of the year reflected resilient consumer spending, a rebound in investment in equipment and software, and a strong positive contribution from private inventories. On the other hand, growth was held down by lower state and local government spending, as well as declining investment in residential and business construction. In addition, net trade subtracted 0.7 percentage point from real GDP growth, as the increase in imports outpaced that in exports.

In Japan, real GDP expanded in the first quarter of 2010 by 1.2% quarter on quarter according to the first preliminary data release of Japan’s Cabinet Office. Economic activity was mainly driven by net exports of goods and services, which accounted for 0.7 percentage point of the quarterly real GDP growth, and by private demand (0.5 percentage point).

Looking ahead, Japan’s economy is expected to remain on a recovery trend. However, growth momentum is likely to slip in the course of 2010 following the waning impact of fiscal stimulus measures on domestic consumption and stabilization in the growth of net exports.

1/ Sections 7.1 – 7.4 are excerpted from European Central Bank Monthly Bulletins, June, 2010
Economic activity in the euro area has been expanding since the middle of 2009. Euro area real GDP grew, on a quarterly basis, by 0.2% in the first quarter of 2010, after increasing by 0.1% in the final quarter of 2009. These developments have confirmed the expectation that the economic recovery in the euro area would be moderate and follow an uneven path. Available indicators suggest that some further strengthening in GDP growth may have taken place in the spring of 2010.

In the United Kingdom, economic growth has also been making a gradual recovery recently. Real GDP increased by 0.3% quarter on quarter in the first quarter of 2010, compared with a 0.4% increase in the fourth quarter of 2009. Economic growth in the first quarter of 2010 was mainly driven by a positive contribution from inventories, while household expenditure remained unchanged and net trade continued to weigh negatively. Overall, activity indicators suggest that the gradual improvement in the economic situation has continued in recent months. As regards house prices, following several months of recovery in 2009, the upward trend continued in year-on-year terms in the first quarter of 2010, notwithstanding some monthly volatility. Credit flows continued to recover slowly, at a pace well below that witnessed in 2008. Looking ahead, activity is expected to continue its gradual recovery, supported by lagged effects of the depreciation of the pound sterling, the monetary stimulus and the improvement in overall global conditions.

The economic situation has also continued to improve in recent quarters in the other non-euro area EU countries. In most countries, real GDP growth returned to positive territory and capacity utilization rates increased in manufacturing. For instance in Sweden, real GDP increased by 1.4% quarter on quarter in the first quarter of 2010, after growth of 0.4% in the fourth quarter of 2009. In Denmark, output increased by 0.6% in the first quarter of 2010, up from 0.1% in the fourth quarter of 2009. This gradual recovery mainly reflected the continued improvement in external demand, the gradual pick up in consumer confidence and also, in some countries, the effects of currency depreciation compared with pre-crisis
levels. Overall, short-term activity indicators suggest continuing recovery.

In the largest central and eastern European EU Member States, the economic situation has improved considerably in recent quarters. However, the growth pattern has differed markedly across countries, reflecting, among other factors, the impact of fiscal adjustment in some countries and differences in inventory cycles. Among the largest central and eastern European EU countries, only Romania registered negative growth in real GDP in the first quarter of 2010, where it stood at -0.3% quarter on quarter. At the same time, growth turned out to be particularly strong in Hungary at 0.9% quarter on quarter. In the Czech Republic and Poland, growth stood at 0.5%. Overall, recent confidence indicators as well as industrial production and trade figures point to an improvement in activity in all four countries. At the same time, a number of factors – including rising unemployment and weak credit conditions (particularly in Hungary and Romania) – point to continued weakness in domestic demand.

In Russia, real GDP contracted by 7.9% in 2009. Preliminary quarterly figures for the first quarter of 2010 suggest that the recovery of output – which started during the third quarter of 2009 but lost pace in the fourth quarter – remained sluggish. Leading indicators of economic activity suggest that output growth might have accelerated during the second quarter of 2010 on the back of a robust expansion of investment and construction. The main risks to a swift recovery stem from weaker than expected commodity prices and subdued credit growth.

In emerging Asia, GDP growth accelerated further in the first quarter of 2010. Strong external demand and supportive fiscal and monetary policies contributed to the strength in economic activity almost uniformly in the region. Albeit less consistent across countries, private domestic demand has also become an important driver of growth.

In China, real GDP growth accelerated to 11.9% year on year in the first quarter of 2010, the strongest pace since the fourth quarter of 2007. Although the policy stimuli continue to fuel growth, private domestic demand – both
investment and consumption – has become increasingly self-sustained. External demand is recovering as well, though the surge in nominal imports – derived in part from strong demand for raw materials and higher import prices – explains the shrinking trade surplus witnessed since the beginning of 2010.

In Korea, real GDP rose by 8.1% year on year in the first quarter of 2010, up from 6.1% in the previous quarter. The increase in GDP growth was mainly due to a solid export performance as well as government spending. In India, the slowdown in economic activity reported by the revised data for the fourth quarter of 2009 was due to temporary factors, in particular a poor harvest. In the first quarter of 2010 GDP recorded robust growth of 8.6% year on year, driven by the revival in agriculture.

Overall, emerging Asia’s strong economic performance is expected to continue for the remainder of 2010 as the underlying factors of the rebound – supportive fiscal and monetary policies and rising world and domestic private demand – remain in place.

In Latin America, the pace of economic activity continued to strengthen in the first quarter of 2010. In Mexico, real GDP grew by 4.4% compared with a year earlier, after falling by 2.4% in the fourth quarter of 2009. In Argentina, economic activity grew solidly in the first quarter of 2010, with industrial production increasing at an average rate of 9.0% year on year, after increasing by 5.3% a quarter earlier. In Brazil, high frequency indicators suggest that economic activity strengthened substantially in the year to March, with industrial production rising by 18.1% on average, after having increased by 5.9% in the fourth quarter of 2009. Overall, output growth is expected to continue to strengthen throughout 2010 in the region as a whole, thanks to strengthening external demand, particularly for commodities, and continued robust domestic demand.

7.2 Inflation Developments

Global inflation has increased mainly on account of higher commodity prices, but underlying inflationary pressures remain rather contained overall, particularly in major advanced economies, in line with low capacity utilization and well anchored inflation expectations. In the OECD area, headline consumer price
inflation was 2.1% in the year to April, unchanged from the previous month. Excluding food and energy, annual CPI inflation declined to 1.2% in April 2010, the lowest level on record. In some emerging economies, by contrast, inflationary pressures have been surfacing, supported by buoyant domestic demand.

In the United States, annual CPI inflation stood at 2.2% in April, broadly in line with the observed average rate of inflation in the year to date. The increase in inflation in the early months of 2010 – compared with an average of -0.4% in 2009 – largely stems from the rebound in energy prices, following previous marked declines. Excluding food and energy, annual inflation slowed further to 0.9% in April, the lowest rate since January 1966.

Consumer price inflation in Japan remained negative owing to the significant slack in the economy. Overall, annual CPI inflation declined by 1.2% in April compared with 1.1% in March. Annual CPI inflation excluding fresh food and energy stood at -1.6%, while CPI inflation excluding fresh food fell to -1.5%.

In United Kingdom, annual CPI inflation has continued to increase in recent months, standing at 3.7% in April. The expiration of the temporary VAT rate reduction and increases in energy prices played a key role in the increase in inflation in early 2010. Looking forward, inflation is expected to moderate as spare capacity will exert a dampening influence on price dynamics.

Euro area annual HICP inflation was 1.6% in May 2010, according to Eurostat’s flash estimate, after standing at 1.5% in April. The rise in inflation over recent months mostly reflects higher energy prices. Looking ahead, inflation rates should, overall, remain moderate. Upward pressures on commodity prices may persist, while euro area domestic price pressures are expected to remain low. This assessment is also reflected in the June 2010 Euro system staff macroeconomic projections for the euro area, which foresee annual HICP inflation in a range between 1.4% and 1.6% for 2010 and between 1.0% and 2.2% for 2011.

In Russia, inflation continued to ease to 6.1% in April as earlier Rouble
appreciations dampened import price growth. While inflation might continue to fall in the short term, price pressures might re-emerge in the medium term owing to recovering domestic demand and accelerating capital inflows.

Inflationary pressures in China continue to increase, with CPI inflation reaching 2.8% year on year in April, mainly on account of rising food and raw material prices. In Korea Annual CPI inflation was 2.6% in April, compared with 2.3% a month earlier.

Inflation pressure picked up across Latin America region. In Mexico, annual price inflation averaged 4.8% in the first quarter compared with 4.0% in the final quarter of 2009. Meanwhile, inflationary pressures in Argentina picked up significantly. More specifically, annual CPI inflation averaged 9.0% in the first quarter of 2010, up from 7.1% in the last quarter of 2009. Inflation in Brazil also picked up to reach 4.8% in the first quarter of 2010.

### 7.3 Commodity Price

Oil prices have made a strong recovery since the second quarter of 2009 and currently stand at a level about 90% higher than the lows reached in the first half of last year. During the last three months, however, oil prices have been subject to considerable volatility. Following strong demand-driven rises during April, oil prices declined considerably in May and early June amid renewed tensions in the financial markets. Looking ahead, market participants are expecting higher oil prices in the medium term, with futures contracts for December 2012 trading at around USD 84.4 per barrel.

Regarding oil market fundamentals, global oil demand is still recovering from the low levels recorded in the second quarter of 2009, mainly driven by continued rises in non-OECD oil demand. On the supply side, OPEC production has remained ample as OPEC members are producing well above their target. Oil inventories increased from the second half of 2009 onwards, largely as a result of high OECD inventory levels.

Meanwhile, the International Energy Agency (IEA) has revised its oil demand forecast for 2010 upwards on the back of higher growth in non-OECD oil demand. On the other hand, the IEA also projects non-OPEC oil supply to increase owing
to higher production expectations for the United States and Canada, which will contribute to the dampening of demand-side price pressures.

After having recovered during most of 2009 and early 2010, the prices of non-energy commodities have decreased in the last three months. Apart from a short-lived recovery in April, food prices continued to decline, mostly as a result of ample supply. Despite declining over the last few months, metal prices displayed volatile behavior driven by the interplay of strong fundamentals concerning metal demand and strains in financial markets. In aggregate terms, the price index for non-energy commodities (denominated in US dollars) was almost 5% higher in early June than at the beginning of the year.

7.4 Exchange Rate Development

Over the past three months the euro has remained on a path of broad-based depreciation, in nominal effective terms, reaching a level well below its 2009 average. The depreciation of the euro, which has been particularly pronounced vis-à-vis the US dollar and the Japanese yen, has been accompanied by a sharp increase in the implied volatility of the bilateral exchange rates of the euro vis-à-vis other major currencies, both at the short and long horizons.

In the three-month period to 9 June, the euro continued to weaken against the US dollar, reaching a level last seen in early 2006, which was well below its 2009 average. Over the same period, the implied volatility of the USD/EUR exchange rate increased, shifting sharply upward in early May, especially at the short horizon.

After strengthening in 2009, the euro started to depreciate vis-à-vis the Japanese yen at the beginning of 2010. During the three months to 9 June the euro continued to depreciate vis-à-vis the Japanese yen, completely reversing its appreciation in 2009 and reaching a level last seen at the end of 2001. Over the same period the implied volatility of the JPY/EUR exchange rate increased sharply, to reach levels last seen in the first quarter of 2009.

The euro has depreciated vis-a-vis the pound sterling (7.5%) over the past three months, trading on 9 June at GBP 0.83. At the same time, the implied volatility
of the GBP/EUR exchange rate increased at the short horizon and the euro strengthened vis-à-vis the Polish zloty (3.6%) and the Hungarian forint (4.4%).

The euro weakened vis-à-vis the Swiss franc, falling by around 6% over the three months to 9 June, to CHF 1.38. Over the same period the bilateral euro exchange rates vis-à-vis the Chinese renminbi and the Hong Kong dollar moved in line with the USD/EUR exchange rate. During this period, notwithstanding a sharp rebound in mid-May, the euro weakened against major commodity currencies, such as the Canadian dollar (by 12.7%) and the Australian dollar (by 5.0%).

The Birr has depreciated against USD and Japanese Yen but appreciated vis-à-vis Euro and Pound Sterling at different rates. For instance, it depreciated by 4.3 and 3.1 percent on quarterly basis in the third quarter of 2009/10 against USD and Yen respectively. But, it appreciated by 1.8 and 0.3 percent with respect to Euro and Pound Sterling respectively during the same period.

7.5 Impact of Global Economic Developments on Ethiopian Economy

In response to global economic recovery, Ethiopian external sector has continued to show growth as earning from merchandise exports grew by 51.2 percent in the third quarter of 2009/10 relative to the preceding quarter and 36.7 percent over the same period last year owing to the improvements in both volumes and international prices of most export items.

Similarly, the receipts from private transfers increased by 9.8 percent during the review quarter against the previous quarter and by 53 percent a year earlier. Inflow of estimated foreign direct investment rose by 273.5 percent on annual basis in the third quarter of 2009 as investment opportunities improved.

The continued recovery of global economy, particularly in the advanced nations is expected to have a positive impact on Ethiopia’s exports, tourism receipts, private remittances and FDI inflows. On the other hand, the oil price in the global market is anticipated to remain moderate and it is unlikely to put
increased burden on balance of payments and macroeconomic stability of the country.