I. OVERVIEW

1.1 International Economic Developments and their impact on Ethiopian Economy

The global economy has continued to expand, though at varying degree during the third quarter of 2009/10 and short-term indicators point out that the growth will continue in the remaining quarter of 2009/10. The positive development in advanced economies has been accompanied, among others, by growth in real GDP, increase in consumer confidence and consumer spending. In euro and non- euro areas, there has been expansion in real GDP, improvement in internal and external demand, increase in housing prices and industrial production while in emerging Asia, private domestic demand surged and inflation rose due to higher commodity prices including oil. Oil prices which were USD 76 per barrel in the month of March 2010 are estimated to increase modestly to around USD 84 per barrel in December 2011, as a result of a growing demand for oil particularly from emerging economies surpassing the anticipated increase in oil supply from oil producing countries.

The global economic recovery is expected to have positive impact on Ethiopia's external sector performance during the third quarter of 2009/10. There has already been a 51.2 percent growth in export of goods over last year same period, owing to surge in both volume of export and international price of most export commodities. Receipts from private transfers (including remittances) rose by 9.8 percent against preceding quarter and 53 percent relative to a year ago while FDI inflows surged by 273.5 percent year-on-year basis.

On the other hand, the country's growing demand for import and rising prices for imports such as fuel, capital goods etc are likely to put pressure on the country's current account balance and international reserves.

Performance of the Ethiopian Economy in the Third Quarter of 2009/10

Headline inflation stood at 1.6 percent in the review quarter, 1 and 5.8 percentage points above the preceding quarter and same quarter of last year, respectively. Food inflation alone contributed to the quarterly increase in headline inflation. However, the 5.8 percent increase in annual inflation was on account of rise both in food inflation (7.1 percent) and non- food inflation (2.9 percent).

The monetary policy continued to focus on stabilizing prices and building up of international reserves. Accordingly, broad money supply (M_2) reached about Birr 96 billion, showing 5.2 percent quarterly increase and 19.2 percent annual growth, due to sizeable increase in net foreign assets and marginal expansion in net domestic credit, mainly to non-government sectors.

Reserve money picked-up by 9.0 and 21.8 percent to Birr 50 billion compared to preceding quarter and a year ago, respectively, owing to an increase both in currency in circulation and commercial banks' deposit at NBE. Year-on-year basis, currency in circulation rose by 17 percent while commercial banks' deposits at NBE went up 28 percent.

As for interest rate, the average saving deposit and lending rates of commercial banks remained unchanged in March 2010 from their respective levels of 4.5 and 12.25 percent in December 2009. Average time deposit rates, however, slightly dropped by 4.2 percent to 4.77 percent compared to last year while weighted average demand deposit rate grew by 7.5 percent to 0.057 percent. At the same time, weighted average yield on T-bills increased to 0.793 percent from 0.661 percent a year ago while average bond yield remained at 4.0 percent.

The Ethiopian financial sector has been stable and growing. The number of banks and insurance companies operating in the country reached 15 and 12 in the stated period, respectively.

In terms of branch expansion, 13 new bank branches and 4 new insurance branches were opened and there by raising the total number of bank and insurance branches in the country to 676 and 205, respectively. In addition, there were 30 micro finance institutions (MFIS) focusing on small income groups. Total amount of deposit mobilized by MFIs grew 3.1 percent to Birr 2.5 billion and their total outstanding credit went up 1.1 percent to Birr 5.2 billion relative to the second quarter ended December 2009.

Total resources mobilized by the banking sector peaked-up 70 percent to Birr 14.4 billion over a year ago, owing to substantial growth in net deposits, net borrowing and loan collection. Disbursement of fresh loans also rose 7.2 percent to Birr 6.5 billion.

With respect to external sector development, export proceeds stood at USD 556 million, 38.4 percent above last year. The remarkable growth was attributed to higher earnings from all export commodities, except oilseeds. Quarterly imports also went up by 26.4 percent to USD 2.2 billion, due to an increase in import payments, except raw materials and thus, merchandise trade deficit widened by about 22.7 percent compared to a year earlier.

Services account registered a surplus of USD 131 million, 27.8 percent higher than last year same period. Like wise, total net transfers stood at USD 1.4 billion, showing annual growth rate of 81.6 percent, as a result of a significant rise in official transfers (158 percent) and private transfers (53 percent). Remittance inflows exhibited a quarterly and yearly growth of 8 and 17.7 percent, respectively. All in all, the current account balance in the stated period depicted a deficit of USD 39.3 million, 90.3 percent narrower than a year earlier while the capital account recorded a surplus of USD 555.4 million, resulting in BOP surplus of USD 246.1 million in the third quarter of 2009/10.

The exchange rate of the Birr against USD in the foreign exchange market was Birr 13.1342, about 4.4 and 19.9 percent weaker on quarterly and annual basis, respectively. Meanwhile, the exchange rate of the Birr against USD in the parallel market reached 13.8495. Hence, the spread between the official and parallel market rates narrowed to 5.45 percent from 6.42 percent in preceding quarter or 17 percent last year same period, owing to faster depreciation of the Birr in official market. Mean while, the real effective exchange rate of Birr continued to depreciate as a result of a decline in inflation differential with trading partners and steady depreciation of the nominal exchange rate. Consequently, real effective exchange rate depreciated by 4.2 percent on quarterly and 29.4 percent annually. This trend is expected to improve the external competitiveness of the country to a certain extent.

The review period also witnessed improvements in government fiscal operations. Federal government revenue and grants reached Birr 11.14 billion, showing a 54.9 percent annual growth, owing to substantial increase in grants. Federal government expenditure also rose by 18 percent to Birr 14.4 billion; resulting in a fiscal deficit of Birr 3.3 billion, lower than preceding period and a year ago. The deficit was largely financed by domestic credit and external loans.