I. OVERVIEW

International Economic Developments

Global economic recovery has continued but its pace is tamed as the impact from the inventory cycle and fiscal stimuli waned. Annualized quarter-on-quarter global real GDP growth in the United States stood at 2.0 percent in the third quarter of 2010 driven primarily by robust consumer spending and inventory accumulation. Business investment growth also remained solid, which more than offset the weakness in residential investment. Meanwhile, growth was dampened by a large negative contribution from net exports, which was nevertheless smaller than in the second quarter.

In Japan, economic activity has been losing momentum recently, with quarter-on-quarter real GDP growth slowing down from 1.2 percent in the first quarter of 2010 to 0.4 percent in the second quarter while in the United Kingdom, the economic recovery has continued. Economic growth in emerging Asia remained buoyant in the third quarter of 2010. Nevertheless, the pace of expansion has slowed somewhat compared with the preceding quarter as suggested by indicators on industrial production and exports as well as some early GDP estimates for the third quarter. In China, annual real GDP growth decelerated further to 9.6 percent in the third quarter of 2010 from 10.3 percent and 11.9 percent in the second and first quarters, respectively. In Latin America, economic activity has remained buoyant. For instance, in Brazil, industrial production grew at an annual rate of 8.9 percent in August 2010, after 8.8 percent in July whereas Argentina's economic activity continued to grow rapidly, with industrial production expanding by 10.1 percent on an annual basis in September 2010.

Developments in Major Macroeconomic Indicators in Ethiopia

Inflation

The first quarter of 2010/11 was marked by an upward trend in general and food inflation but a decline in core inflation. Headline inflation rose by 0.4 percentage point in the review period and reached 2.1 percent primarily due to 0.8 percentage point hike in food inflation despite 0.1 percentage point drop in non- food inflation.

Monetary Developments

During the quarter under review, broad money supply (M2) registered quarterly and annual growth rates of 3.9 and 24.4 percent, respectively to reach Birr 108.5 billion, mainly on account of higher net foreign assets. Net foreign assets was Birr 38.0 billion at the close of September 2010, revealing 39.8 percent quarterly and 94.6 percent annual increases. Net domestic credit, on the other hand, went up by 0.5 and 14.1 percent over the same period to Birr 104.4 billion, of which Birr 73.6 billion or 70.2 percent was claims on the private sector.

Reserve money picked up by 5.5 percent to reach Birr 53.3 billion vis-à-vis the previous quarter owing to a 14.5 and 3.2 percent growth in commercial banks' deposit at NBE and currency in circulation, respectively. Year-on-year basis, reserve money grew by 23.9 percent as currency in circulation scaled up by 30.5 percent counter balancing a 2.1 percent decline in commercial banks' deposit at the Central Bank.

Interest rate

Average saving deposit rate and average lending rates remained unchanged from their respective levels of 4.5 and 12.3 percent at the end of June 2010 whereas the weighted average time deposit rates depicted a quarterly and annual decrease of 1.6 and 12.6

percentage points. Weighted average demand deposit rate marginally picked up by 0.4 percentage point over the preceding quarter but declined by 14.3 percentage point on annual basis. At the same time, weighted average yield on T-bills slightly increased to 0.984 percent from 0.843 percent a year ago, while average bond yield remained at 4.0 percent. Considering 2.1 percent inflation during the quarter, all interest rates, except T-bill yields, were positive in real terms.

Financial Sector Developments

Pertaining to financial sector development, the number of banks operating in the country remained unchanged from the preceding quarter of 15. Insurance companies, however, increased to 13 during the quarter. The number of microfinance institutions remained at 30. In terms of branch expansion, 31 new bank branches were opened in the review period (of which 12 were by CBE) and 2 new insurance branches by private insurance companies. Hence, the total number of bank and insurance branches rose to 712 and 209, respectively. Accordingly, bank branch to population ration reached 112,000 by end September 2010.

Total resource mobilized by the banking sector registered quarterly and annual increases of 22.0 and 15.3 percent to reach Birr 14.8 billion. The quarterly surge was due to 61.3 percent increase in net deposits and 9.4 percent in loan collection while net borrowing declined by 61.2 percent. Disbursement of new loans has increased by 22.0 and 35.4 percent over the previous quarter and last year same period, respectively to Birr 8.5 billion. Of the total new loans, 69.4 percent was disbursed by private banks. About 93.6 percent of the loans went to finance the private sector including cooperatives.

Loans collection of the banking sector has also increased by 9.4 and 42.3 percent over the preceding quarter and same quarter of last year and reached Birr 8.8 billion at the end of September 2010.

The banking sector managed to mobilize deposit amounting to Birr 104.5 billion at the close of the first quarter of 2010/11 witnessing 5.9 and 23.8 percent quarterly and annual increase, respectively. The share of private banks was 40.4 percent of the total stock of deposits mobilized.

Meanwhile, microfinance institutions mobilized Birr 2.8 billion in deposits and extended credit to the tune of Birr 6.1 billion compared to Birr 5.8 billion in the preceding quarter

External Sector and Foreign Exchange Developments

With respect to external sector development, quarterly export proceeds stood at USD 653.4 million, about 64.5 percent higher than the last year same quarter but 22.9 percent lower vis-à-vis the preceding quarter. The quarterly decline in export proceeds was mainly attributed to the decline in the volume of major exports namely, coffee, oilseeds, gold and flowers, among others.

Total imports registered a decline of 10.3 percent on quarterly basis and amounted to USD 1.8 billion during the period under review owing to slowdown in imports of semi finished goods (12.4 percent), fuel (19.4 percent), consumer goods (23.1 percent) and miscellaneous (17.9 percent). Imports of raw materials and capital goods, however, showed a 43.8 and 10.8 percent increase, respectively.

As a result, the trade balance depicted a deficit of USD 1.23 billion which was 14 percent lower than a year earlier as a result of improved export performance.

Meanwhile, net transfers declined to USD 999.8 million from USD 1.1 billion in the preceding quarter owing to 26.2 percent decrease in private transfers offsetting the 46.3 percent surge in official transfers. Year-on-year basis, net transfer was 2.7 percent higher than last year due to the increase in public transfers.

Services account exhibited a surplus of USD 241.6 million in contrast to a deficit of USD 9.0 million in the preceding quarter and a surplus of USD 118.7 million a year ago. The increase in the surplus of services account was ascribed to higher revenue from travel and transportation.

To sum up, the current account balance including public transfer in the period depicted a surplus of USD 12.0 million whereas the capital account registered a surplus of USD 374.7 million, resulting in USD 257.8 million BOP surplus, higher than USD 179.5 million surplus in the preceding quarter.

In the foreign exchange market, the official exchange rate of Birr against USD was Birr 14.55, exhibiting depreciation of 8.0 and 17.6 percent compared with that of a quarter before and a year earlier, respectively. Meanwhile, the exchange rate of Birr against USD in the parallel market reached 14.98. Hence, the spread between the official and parallel market rates of Birr against USD narrowed to 2.95 percent from 7.14 percent in the preceding quarter.

Federal Government Fiscal Operations

In the first quarter of 2010/11, federal government fiscal operations witnessed a 42.0 percent yearly surge in total revenue and grants. On the other hand, total expenditure increased by 28.0 and 10.0 percent over the same quarter of last year and the previous quarter, respectively.

Tax revenue amounted to Birr 10.8 billion, registering a quarterly increase of 8.0 percent and year-on-year surge of 50 percent. Meanwhile, non-tax revenue showed a 17.0 percent quarterly slowdown but annual growth of 33 percent. Grants scaled down by about 34.0 percent on quarterly terms although its annual increase was 166 percent. .

Quarterly growth in total expenditure was on account of 28.8 percent surge in capital expenditure despite 28.1 percent drop in recurrent expenditure. Year-on-year basis however, total expenditure increased by about 30 percent as both recurrent and capital expenditures scaled up.

Therefore, the overall fiscal balance (including grants) revealed a deficit of Birr 1.95 billion significantly higher than Birr 224.0 million deficit in the preceding quarter but 25 percent lower than a year earlier. The quarterly fiscal deficit was financed by net external borrowings of Birr 1.1 billion, privatization proceeds of Birr 38.0 million and other sources and residuals of Birr 4.2 billion. Meanwhile, there was a repayment of Birr 3.33 billion to domestic banking system.

Investment

The total number of investment projects licensed during the first quarter of fiscal year 2010/11 was 2,294 with an aggregate capital of Birr 39.0 billion. Out of the total capital, 47 percent was from foreign projects and the balance from domestic projects. Upon commencement of operation, the approved investment projects are expected to create employment opportunities for 75,740 permanent and 146,761 casual workers.

Fuel prices

As international crude oil on average increased during the quarter, domestic retail prices of petroleum products were adjusted upwards. In Addis Ababa, the average fuel prices have increased to Birr 11.3 per liter from Birr 11.1 in the previous quarter and Birr 8.7 a year earlier.