

8. International Economic Developments

8.1 Overview of the World Economy^{1/}

The recovery in the global economy is continuing and becoming increasingly self sustained. The GDP data releases for the third and fourth quarters have confirmed that the recovery in the global economy continued in the second half of 2010, albeit at a more moderate pace than in the first half of the year. At the sometime, the strength of the recovery differs across regions. The latest indicators are signaling that the firming of momentum in global growth, which occurred over the course of the final quarter of 2010, has continued in early 2011.

In the United States, the economy continued to recover in the final quarter of 2010. According to the advance estimate by the Bureau of Economic Analysis, quarter-on-quarter real GDP growth stood at 0.8% (3.2% in annualized terms), up from 0.6% in the third. The acceleration reflected stronger momentum in consumer spending growth and a positive contribution from trade, as exports continued to grow and imports declined. Investment in equipment and software also rose, but at a slower pace compared with previous quarters. By contrast, growth was held down by a significant negative contribution from inventory accumulation. In terms of volume, the level of GDP in the fourth quarter exceeded, for the first time, the pre-recession peak reached in the fourth quarter of 2007. Looking ahead, the recovery is expected to remain moderate in the medium term.

In Japan, available data point to a deceleration in economic activity in the fourth quarter of 2010, mainly on the back of weak household spending, which declined for a third consecutive month in December by 3.3% year-on-year term. Even so, survey data provided positive signals. The Economy Watchers Survey rose for a second consecutive month in December, with economic sentiment picking up across a wide range of sectors. The January PMI for manufacturing stood at 51.4, above the expansion/contraction

^{1/} Section 9.1 and 9.2 are excerpted from European Central Bank monthly bulletin for Feb 2011 while section 9.3 and 9.4 are taken from Jan 2011.

threshold of 50, indicating acceleration in manufacturing activity. There are signs emerging of renewed growth in export-oriented sectors as exports improved in November and December, and industrial production increased for the first time in six months in November. Looking ahead, economic activity is likely to accelerate moderately in the first quarter of 2011, supported mainly by continued strong growth in the emerging Asian economies. However, private consumption is expected to remain subdued in the absence of further fiscal stimulus plans.

In the United Kingdom, the economic recovery has faltered in recent months. According to preliminary estimates, real GDP decreased by 0.5% quarter on quarter in the fourth quarter of 2010 after expanding by 0.7% in the third quarter. Attributed in part to bad weather in December, the decline in output over the quarter was driven by the services and construction sectors. House prices have continued their trend of decline in recent months against the background of subdued housing market activity. Looking ahead, inventory adjustments, the monetary stimulus, external demand and the past depreciation of the pound sterling should support economic activity. However, growth in domestic demand is expected to remain constrained by tight credit conditions, household balance sheet adjustment and substantial fiscal tightening.

In the largest central and eastern European EU countries, the recovery continued in the third quarter of 2010 mainly supported by external demand and the rebuilding of inventories. Domestic demand remained rather subdued in most countries owing to weak labour and credit market conditions, low capacity utilization as well as fiscal restraint in some countries. Romania was the only large central and eastern European country with negative growth in the third quarter of 2010, which was due to the short-term impact of the ongoing fiscal adjustment along with a deteriorating labour market situation. In contrast, growth was especially robust in the third quarter in Poland where, in addition to external demand, improvements in the labour market situation supported the recovery.

The economic situation continued to improve in the third quarter in the other non-euro area EU countries, while developments in inflation were mixed. Real GDP increased by

2.1% and 1.0% quarter on quarter in the third quarter of 2010 in Sweden and Denmark respectively, suggesting that the recovery gained pace in both countries. The recovery appears to be especially robust in Sweden, supported both by external demand and domestic consumption on the back of strong employment growth.

In China, real GDP increased by 9.8% year on year in the fourth quarter of 2010, up from 9.6% in the third quarter, which points to the economy's resilience to the withdrawal of stimulus measures in the course of 2010. Investment remained the main source of GDP growth in the fourth quarter of 2010, while the contribution of consumption to GDP growth declined and is now below the long-term historical average. The contribution of net exports to growth remained positive in the last quarter of 2010 owing to strong external demand.

8.2 Inflation Developments

In advanced economies, inflationary pressures remain contained, although input prices have been increasing as a result of higher food and commodity prices. In fast-growing emerging economies, inflation rates have continued to increase on account of these input price increases combined with strong economic activity. Annual headline inflation in the OECD countries increased to 2.1% in December, compared with 1.8% in November. Excluding food and energy, annual inflation was 1.2% in December, unchanged from November.

Price pressures in the United States remain contained in the context of substantial economic slack. Annual CPI inflation picked up to 1.5% in December, exceeding, for the first time, the tight range of 1.1% to 1.2% registered since June 2010. The increase in consumer prices primarily reflected the impact of higher energy costs. Excluding food and energy, annual inflation remained unchanged in December, standing at 0.8% and averaging 1% in 2010, down from 1.7% in 2009.

In Japan, annual CPI inflation stood at 0% in December, after having risen for two consecutive months in November and October. Annual CPI inflation excluding fresh food stood at -0.4%, whereas excluding fresh food and energy, it stood at -0.7%.

In the United Kingdom, Annual CPI inflation has remained elevated, increasing to 3.7% in December 2010, up from 3.3% in November. Looking ahead, the lagged effects of the depreciation of the pound sterling, higher commodity prices and the increase in the rate of VAT in January 2011 are expected to exert further upward pressure on consumer prices.

In December, China's annual CPI inflation eased to 4.6%, down from 5.1% in November, owing to base effects and a deceleration in food price inflation in response to the administrative measures introduced in November. However, high commodity prices and abundant domestic liquidity are expected to keep inflationary pressures high in the first half of 2011. Property prices also continued to increase in December, for the fourth consecutive month.

8.3 Commodity Markets

Oil prices increased in December and early January. Brent crude oil prices stood at USD 96.7 per barrel on 12 January 2011 which is 23.7% higher than at the beginning of 2010, and 11.7% higher than at the beginning of December. Looking ahead, market participants still expect slightly higher oil prices in the medium term, with futures contracts for December 2012 trading at around USD 96.9 per barrel.

Looking at fundamentals, the demand side of the market is continuously proving its robustness and the International Energy Agency (IEA) has been revising its demand estimates for 2010 upwards. On the supply side, the response to higher demand and prices was however more muted, and OPEC decided not to modify production quotas during its last meeting. This translated into a substantial inventory drawdown which, taking into account that the IEA expects global demand to rise by 1.5% in 2011, may hint at tighter market conditions in the near future.

The prices of non-energy commodities also increased significantly in December. Food prices continued to increase strongly, driven in particular by wheat, maize and sugar. Price increases were motivated by a combination of robust demand and supply concerns related to adverse weather conditions in the southern hemisphere. Metal prices have also increased, driven mainly by copper, due to pressure from supply-side constraints. In aggregate terms, the price index for non-energy commodities (denominated in US dollars) was 29% higher at the beginning of 2011 than at the beginning of 2010 and 7.5% higher than at the beginning of December 2010.

8.4 Exchange Rate Development

In the fourth quarter of 2010, the euro depreciated in nominal effective terms, moving below its average level for the year. On 12 January 2011 the nominal effective exchange rate of the euro – as measured against the currencies of 20 of the euro area's most important trading partners – was 4.3% lower than at the end of September and 4.0% below its average level for 2010.

In bilateral terms, during the fourth quarter of 2010, the euro depreciated against all major currencies. Between 30 September 2010 and 12 January 2011, it weakened against the Swiss franc by 5.0%, the Japanese yen by 4.8% and the US dollar by 4.9%. The depreciation of Euro against the US dollar, combined with the corresponding depreciation against currencies that are tied to the US currency, accounted for almost half of the overall depreciation in effective terms. The single currency also depreciated significantly vis-à-vis the so-called commodity currencies (Australian dollar, Canadian dollar and Norwegian krone) and against the pound sterling.

During October – December 2010, the Birr weakened with respect to major international currencies at different rates. For instance, it depreciated year-on-year against Japanese Yen by 42.5 percent, Swiss Frank 37.2 percent and 26.6 and 21 percent relative to Pound

Sterling and Euro respectively in the second quarter of 2010/11. Over the preceding quarter, the Birr recorded highest depreciation rates of 20.1 and 19.4 percent respectively and followed with 17.9 and 16.2 percent vis-à-vis Japanese Yen and pound Sterling respectively.

8.5 Impact of Global Economic Developments on the Ethiopian Economy

The external economy of Ethiopia has proceeded to expand largely supported by the continuous global economic recovery. Following a marked growth in commodity export during the first quarter of 2010/11, total merchandise export revenue notably rose by 48.7 percent year-on-year in the second quarter of the year owing to the strong recovery of global commodity prices and enhanced volume of export products.

Similarly, the receipts of private remittances during the second quarter of 2010/11 showed a 18.8 percent growth over the same period last year presumably in response to the expansion of economic activities in advanced nations. Estimated FDI inflows also increased by 11.6 percent in the same period partly owing to the improvement in global financial conditions.

On the other hand, there have been strong upward movements in the international oil prices which accounted for high growth of fuel import bill during the review period. Looking ahead, the pace of world oil price will tend to slow down with marginal rise and hence remain to be the foreign exchange pressure of the country.