

I. OVERVIEW

International Economic Developments and their Impact on the Ethiopian Economy

According to the European Central Bank, the upturn in the global economy is steadfast and becoming gradually more self sustained. The growth data released for the third and fourth quarters have confirmed that the recovery in the global economy has continued in the second half of 2010, although at a more modest pace than in the first half of the year. The strength of the recovery varies 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.

United State's economy has continued to recover in the final quarter of 2010. As per 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 quarter. In Japan, another big economy, fourth quarter data revealed a reduction in economic activity largely on the back of weak household spending, which declined for a third consecutive month in December by 3.3% on annual term. The Economy Watchers Survey rose for a second consecutive month in December, with economic sentiment picking up across a wide range of sectors.

In UK, on the other hand, the economic recovery has weakened in recent months. According to preliminary estimates, real GDP decreased by 0.5% on quarterly basis 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. In China, the second largest economy, real GDP has registered 9.8% annual expansion 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.

Inflation pressure remains contained in advanced economies, although input prices have been increasing as a result of higher food and commodity prices. However, in fast growing emerging economies, inflation rates have continued to increase on account of these input prices increase accompanied by strong economic recovery.

On the other hand, oil prices increased in December 2010 and early January 2011, owing to imbalance between demand and supply, according to International Energy Agency.

Regarding the impact of these developments on the Ethiopian economy, the rise in world food and commodity prices including oil is expected to put pressure on domestic inflation through cost push effect. At the same time, it also created a good opportunity for the country's export sector to expand as economic recovery to loans large in advanced economies.

Macroeconomic Developments in Ethiopia

Inflation

During the second quarter of 2010/11, general inflation reached 5.9 percent up from 0.6 and 2.1 percent in the same quarter last year and the previous quarter, respectively. Year-on-year basis, headline inflation scaled up by 5.3 percentage point as both food and non-food price inflation surged by 7.0 and 2.4 percentage points, correspondingly.

Federal Government Fiscal Operations

In the second quarter of 2010/11, revenues and grants collected by the Federal Government surged by 6.9 percent to reach Birr 15.4 billion from Birr 14.4 billion in the previous quarter. The quarterly revenue and grant performance was 27.7 percent against the annual budget. A total of Birr 13.8 billion was collected in tax revenue, 27.7 and 32.8 percent surge on quarterly and annual basis, respectively. On the contrary, non-tax revenue showed a 34.7 and 35.8 percent quarterly and annual slowdown, respectively and

stood at Birr 1.6 billion. Grants scaled down by about 97.5 and 98.6 percent on quarterly and annual terms, respectively.

Total Federal Government expenditure (including regional transfers) was Birr 17.5 billion, up by 17.7 and 6.6 percent on annual and quarterly basis, respectively.

The overall budget deficit (including grant) was Birr 2,04 billion, considerably higher than Birr 1.95 billion deficit registered in the previous quarter. The deficit was financed from net external borrowing, privatization receipt and residuals, and there was net repayment to domestic banking and non banking sources.

Investment

850 investment projects with a total capital of Birr 12.1 billion were licensed during the second quarter of 2010/11. The number of approved investment projects decreased by 49 percent vis-à-vis the same quarter of last fiscal year while the amount of capital registered dropped by 43 percent.

Fuel prices

As international crude oil prices on average increased to USD 87 per barrel during the quarter, domestic retail prices of petroleum products were adjusted upwards accordingly. As a result, Addis Ababa average retail price of fuel in Addis Ababa surged to Birr 13.2 per liter from Birr 11.3 in the previous quarter and Birr 10.5 a year earlier.

Monetary Developments

During the second quarter of 2010/11, broad money supply (M2) reached Birr 117.8 billion, showing a surge of 8.6 percent on quarterly and 29.2 percent annual basis. The growth in broad money was on account of a rise both in net foreign assets and domestic credit, particularly of credit to non-government sector. Consequently, net foreign assets and domestic credit stood at Birr 40.2 billion and 110.5 billion respectively by end December 2010. Of the total domestic credit extended in the review period, 75 percent was to non-government sector and the remaining 25 percent to federal government.

Base money/reserve money surged by 6.4 and 22.8 percent on quarterly and annual bases, respectively and reached Birr 56.7 billion at the end of December 2010. Year-on-year growth in reserve money was due to 32.3 percent surge in currency in circulation and 11.0 percent increase in commercial banks' deposit at NBE. On quarterly basis however, currency in circulation increased while commercial banks' deposit at NBE slowed down.

Interest rate

As a result of the recent tight monetary policy which raised the minimum saving deposit rate by one percentage point to 5.0 percent, the average saving deposits rate of commercial banks reached 5.38 percent from 4.50 percent each in the previous quarter and a year ago. Likewise, the weighted average time deposits rate increased to 5.6 percent from 5.29 percent last year. The weighted average yield on T-bills also rose to 1.35 percent from 0.81 percent. Meanwhile, the weighted average demand deposit rate declined to 0.040 percent from 0.65 percent a year earlier.

Financial Sector Developments

At the end of December 2010, the number of commercial banks, including DBE, reached 16, and that of insurance companies and micro finance institutions 13 and 30 respectively. Yet, branch expansion was witnessed largely by banks and insurance companies. As a result, 129 new bank branches and 4 insurance companies were opened in the review quarter, raising the total number of bank and insurance branches in the country to 841 and 213, respectively. Similarly, bank branch to population ratio dropped to 95,124 by end of December 2010 from 112,359 in September 2010.

Resource mobilization of the banking sector in the form of net change in deposits, loan collection and net borrowing increased by 12.6 percent over the previous quarter, owing to the rise in net deposit mobilization (66.9 percent) overweighing the fall in net borrowing (62.2 percent) and loan collection (21.7 percent).

Fresh loans disbursed by the banking sector during the second quarter of 2010/11 was Birr 11.8 billion, up by 62.1 percent on yearly basis. Private banks disbursed 56.9 percent leaving 43.1 percent to public banks. The largest portion of fresh loan by public banks was allocated to agriculture and industry sectors. While private banks, largely lent for finance trade.

During the second quarter of 2010/11, the banking sector collected loans amounting to Birr 6.9 billion, about 21.7 percent lower than the previous quarter but 33.0 percent higher against last year same period. The share of private banks in loan collection was 69.1 percent.

The stock of outstanding credit of the banking system (excluding corporate bond holding) reached Birr 67.3 billion, up by 24.0 vis-à-vis the balance at the end of last year same period. .

The stock of total deposits mobilized by the banking system at the end of the quarter under review scaled up by 30.5 percent on annual basis, and reached Birr 114.1 billion. The growth in deposit mobilization was partly attributed to expansion in bank branch networks. In the meantime, microfinance institutions mobilized Birr 3.1 billion in deposits, up by 9.8 percent. Their credit outstanding and total assets also increased by 2.2 and 6.1 percent to reach Birr 6.2 billion and Birr 8.8 billion, respectively.

NBE's outstanding claims on the government went up by 19.5 percent over last year same period due to the higher direct advance.

External Sector and Foreign Exchange Developments

Merchandise goods export proceed was USD 550.7 million in the second quarter of 2010/11, about 48.7 percent higher than last year. This was mainly attributed to the rise in the volume exports and improvement in international price.

Total import bill of marginally dropped by 3.2 percent annually to USD 2.24 billion, owing to the slowdown in imports of consumer goods, raw materials and semi-finished goods. Consequently, the trade balance depicted narrower deficit of USD 1.7 billion.

Net services account registered USD 130.4 million inflows during the second quarter of 2010/11, down by 39.7 percent as compared to a year earlier. Net transfers increased to USD 1.6 billion from USD 1.2 billion last year on account of higher private and official transfers. Remittances also rose to USD 465.7 million in the review period from USD 208.3 million a year ago.

Accordingly, current account balance (including official transfers) registered a deficit of USD 3.9 million, and capital account USD 664.2 million. Thus, the balance of payments recorded a surplus of USD 114.4 million.

Regarding exchange rate developments, the official weighted average exchange rate of the Birr in inter bank market depreciated by 30.8 percent on annual terms and stood at Birr 16.4667/USD during the second quarter of 2010/11. The Birr also lost ground in the parallel average exchange rate by 26.6 percent to Birr 16.9567/USD. Hence, the average premium between the official and parallel market rates at the end of the second quarter narrowed to 3 percent from 6.4 percent a year earlier.