VII. International Economic Developments

7.1 Overview of the World Economy

Global economic activity has continued to expand at a robust pace and proceed along a more self-sustained path amid improving global financial conditions. According to the latest survey indicators, however, the momentum in global economic growth has recently moderated somewhat from the buoyant growth rates recorded at the turn of this year. At the same time, regional differences with respect to cyclical positions persist. In advanced economies, the impact of natural disasters, the need for firmer fiscal consolidation and continued private balance sheet repair has contributed to the dampening of growth.

In the United States, the economy is continuing its recovery, albeit at a slower pace than in the fourth quarter of 2010. The second estimate confirmed that real GDP increased by 1.8% in annualized terms in the first quarter of 2011, decelerating from the 3.1% pace recorded in the last quarter of 2010. The composition of this increase, however, was revised. The slowdown compared with the previous quarter reflects much softer growth in personal consumption expenditure, while the deceleration in structures investment was slightly less marked. The sharp decrease in government spending was confirmed. Moreover, both imports and exports have been revised substantially upwards, although the negative net trade contribution persists. Real GDP growth continued to be supported by an even more significant positive contribution from inventory accumulation.

In Japan, recent data releases confirmed that the immediate impact on economic activity of the March 2011 Great East Japan Earthquake and the ensuing tsunami was severe. According to the first preliminary release, real GDP contracted by 0.9% quarter on quarter in the first quarter of 2011, a stronger decline than expected by the market, following a decline of 0.8% in the previous quarter. This corresponds to two consecutive quarters of negative growth for the Japanese economy. As a result of the recent events, private inventories declined sharply, making the biggest contribution to negative growth. In addition, private consumption contracted by 0.6%, while private business investment declined by 0.9%. Moreover, net exports also contributed negatively to growth, as imports increased at a faster pace than exports in the first quarter of 2011. Looking ahead, while economic activity in the second quarter of this year is still expected to be negatively affected by the recent events, the experience of past natural disasters suggests that reconstruction demand, together with a gradual normalization of supply conditions, are likely to provide support to economic activity from the second half of this year.

The economic activity in the United Kingdom, recovered in the first quarter of 2011. Real GDP increased by 0.5% in the first quarter of 2011, after declining by 0.5% in the fourth quarter of 2010 and increasing by 0.7% in the third quarter of 2010. On the expenditure side, growth was driven almost exclusively by net exports, while household consumption and capital investment declined. House prices have remained subdued in recent months against the background of sluggish demand in the housing market. Looking ahead, 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.

The economic situation in the other non-euro area EU countries has continued to improve in recent quarters. Real GDP increased by 0.8% quarter on quarter in Sweden in the first quarter of 2011, following an increase of 1.6% in the last quarter of 2010. The robust recovery of the Swedish economy was supported both by external demand and private consumption. The recovery in economic activity in the largest central and eastern European EU countries has gained further strength in recent quarters, mainly driven by external demand. However, at the same time, domestic demand has been restrained by weak labour market conditions, higher commodity prices, the need for deleveraging – not least in the banking sector – and the short-term effects of fiscal consolidation. In the Czech Republic and Hungary, real GDP has been recovering steadily, expanding quarter on quarter by 0.9% and 0.7% respectively during the first quarter. In Romania, real GDP growth increased in the first quarter of 2011 by 0.7% quarter on quarter, suggesting that the economy has started to recover following a contraction in 2010. In all three countries, external demand has played a prominent role in the recovery so far. In Poland, real GDP continued to expand at a quarterly rate of 1.0% in the first quarter of 2011. In contrast to most other countries in the region, output growth in Poland was largely driven by domestic demand, although export growth was also robust.

In emerging Asia, the robust growth momentum of 2010 continued in the first quarter of 2011. Economic growth in the region was driven by both sustained domestic and external demand. In a context of ongoing expansionary fiscal and monetary policies as well as persistent net capital inflows, both private consumption and investment continued to be strong.

The annual real GDP of China showed robust growth of 9.7% year on year in the first quarter of 2011. Growth was mainly driven by strong consumption spending, while the contribution of net exports to GDP growth turned negative. The cumulated trade surplus in the first four months of the year declined to USD 10.7 billion, about 30% below the level of the same period last year, owing to higher commodity prices and stronger construction activity.

In India, real GDP grew by 7.7% in the first quarter of 2011 relative to one year earlier, compared with 9.2% in the last quarter of 2010. Private consumption growth remained strong at 8.1% year on year, while gross fixed investment growth slowed to 0.4% year on year. In South Korea, real GDP increased by 4.0% year on year in the first quarter of 2011, compared with 4.7% in the fourth quarter of 2010. The economic expansion continued to be broad based with the major contributions coming from private consumption and net exports.

The economic performance of the ASEAN-5 countries (i.e. Indonesia, Malaysia, the Philippines, Singapore and Thailand) continued to be buoyant in the first quarter of 2011. Real GDP in Indonesia – the group’s largest economy–increased by 6.5% year on year in the first quarter, after 6.9% in the fourth quarter of 2010. In Indonesia and Malaysia, GDP growth was driven mainly by private consumption and fixed investment, while Singapore and Thailand experienced an increase in net exports.

The outlook for emerging Asia suggests a sustained growth momentum throughout 2011, led by China and India. In this context, concerns about overheating might arise, given closing output gaps and the persistence of inflationary pressures. On the other hand, potential downside risks are related to uncertainties about external demand on account of the turmoil in the Middle East and North Africa as well as the earthquake-related disruptions in Japan, a further rise in commodity prices and financial vulnerability associated with capital flow volatility.

In Latin America, economic activity continued to expand at a rapid pace in the first quarter of 2011, although signs of some moderation became apparent in some economies. The moderation in growth is a result of the gradual unwinding of policy stimulus measures and a normalization of the global inventory cycle. In Mexico, annual real GDP growth stood at 4.4% in the first quarter of 2011, compared with 4.2% in the fourth quarter of 2010. In Argentina, economic activity continued to benefit from very favourable terms of trade and strong demand from Brazil, while the policy stance remained accommodative. As a result, industrial production continued to expand rapidly, at an annual rate of 9.2% in the first quarter of 2011. In Brazil, the pace of growth moderated in the first quarter of this year to more sustainable levels. In more detail, average year-on-year industrial production growth stood at 2.3% in the first quarter, down from 3.3% in the fourth quarter of 2010.

Looking ahead, economic activity in Latin America is expected to continue to grow vigorously, albeit at more sustainable rates. Domestic demand is expected to be the primary driver of growth, and in particular gross fixed investment. Favourable external conditions, strong levels of confidence, and, in some cases, ongoing accommodative policies will further contribute to the economic performance of this region.

Since the beginning of 2011, the performances of many economies in the Middle East and North Africa have been affected by political unrest. Industrial activity in the countries facing prolonged protests, strikes and internal conflicts has fallen; financial markets and distribution networks have been disrupted; tourist arrivals have dropped; and net capital inflows have decreased. At the same time, oil-exporting economies in the region (except Libya) have benefited from the increase in oil prices driven by the heightened geopolitical risk as well as, in some cases, from higher oil production.

As regards the oil importing countries that have not been directly affected by the political upheaval, the recent positive economic developments have stemmed from fiscal and monetary policies remaining accommodative on the whole, higher export growth in some cases, and the rise in the prices of (non-oil) commodities. On the other hand, the increase in the cost of fuel and food may have dampened growth in several countries. In addition, in the first quarter of 2011 higher energy and food prices contributed to a gradual pick-up in inflation in the oil importing countries.

The economic outlook for the Middle East and Africa remains largely positive despite the economic impact of the political unrest in several countries. However, downside risks to growth include the possibility of prolonged political tensions and their potential spillover to other countries and adverse effects of high global food prices and, for the oil importing countries, energy prices.

7.2 Inflation Developments

Global headline inflation continued to increase amid mounting pipeline price pressures, mainly associated with high commodity prices. Although the latest survey indicators suggested some moderation in global inflationary pressures in line with the recent correction in commodity prices and less buoyant activity growth, in May the global PMI for input prices remained at 63.2, which is still well above the long-run average for this indicator, albeit below its level of 66.3 in the first quarter of the year.

In advanced economies, inflation rates steadily increased in the second half of 2010 and have continued to do so in 2011, primarily on account of high oil and non-oil commodity prices. In the OECD area, consumer prices rose by 2.9% on an annual basis in April 2011, compared with 2.7% in March, which is the highest rate of inflation since October 2008. At the same time, inflation excluding food and energy crept up to 1.6%. In advanced countries, the more contained increase in inflation excluding food and energy has been associated with lingering spare capacity and subdued compensation growth in most countries. In fast-growing emerging market economies, by contrast, inflationary pressures have been more pronounced. In March, annual consumer price inflation rose, on average, to around 6.5% in emerging economies, amid increasing capacity constraints and the higher weight of commodities in their consumption basket.

The annual CPI inflation in the United States picked up from 2.2 % in February to 2.7 % in March. The increase stemmed from a continued marked annual rise in energy prices (15.5%) and to a lesser extent, in food prices (2.9%). Excluding food and energy, annual inflation rose to 1.2% in March from 1.1% in February, suggesting that the pass-through of costs is gaining strength as the economic recovery continues.

In Japan, the annual CPI inflation was zero in March for fourth consecutive months, reflecting weak demand. Annual CPI inflation excluding fresh food stood at -0.1% where as -0.7% excluding fresh food and energy.

Annual CPI inflation in the United Kingdom has remained elevated in recent months, decreasing to 4% in March 2011 from 4.4% in February, mainly reflecting the lagged effects of the depreciation of the Pound Sterling, higher commodity prices and the increase in the rate of VAT in January 2011. Looking ahead, these factors are likely to continue to exert upward pressure on annual CPI inflation.

HICP inflation has tended to increase in the majority of other non-euro area EU countries. Annual inflation rates have been broadly stable in recent months in Sweden and Denmark, standing at 1.8% and 2.8% in April 2011 respectively. While in the Czech Republic annual HICP inflation stood at 1.6% in April 2011, in Hungary and Poland it reached 4.4% and 4.1% respectively. Romania has registered the highest inflation rates in recent months, reaching 8.4% in April 2011. Inflation has also increased in recent months, standing at 3.3% in Bulgaria, 4.3% in Latvia and 4.4% in Lithuania in April 2011.

In emerging Asia, inflation pressures increased further in the first few months of 2011, owing initially to high food and commodity prices, but increasingly also as a result of domestic demand pressures. In this environment, gradual monetary tightening by way of interest rate hikes and quantitative measures has continued, while administrative measures to contain food inflation have been implemented in a number of countries.

CPI inflation in China has stayed at elevated levels, recording a 5.3% increase year on year in April, mainly on account of rising food prices and positive base effects. Domestic liquidity expansion has started to slow down in response to the tightening of monetary policy as the People’s Bank of China further raised the reserve requirement ratio (RRR) by 50 basis points in May 2011. Annual wholesale price inflation – the Reserve Bank of India’s preferred measure of inflation – remained high, surging to 9.5% in February 2011 before falling to 8.7% in April. The increase in the inflation rate was initially driven by food and commodity prices, while more recently increasing inflationary pressures have also been coming from the manufacturing sector. In South Korea, annual CPI inflation from January to April 2011 stayed above the target band of 2% to 4%, rising to 4.7% in March before falling to 4.2% in April. Inflation has mainly been driven by agricultural and manufactured products. The Bank of Korea raised its policy rate in both January and March 2011 by 25 basis points to its current level of 3.0%.

Inflationary pressures have been increasing in most Latin America countries in the region. In Mexico, annual consumer price inflation was somewhat lower than in the preceding quarters, averaging 3.5% in the first quarter of 2011. In Argentina, the incipient demand pressures coupled with high commodity prices have resulted in rising inflationary pressures, with annual CPI inflation standing at 10.1% in the first quarter of 2011. Inflationary pressures continued to rise and annual inflation in Brazil reached 6.6% in the first quarter of 2011, a 0.5 percentage point higher than during the final quarter of 2010.

Inflationary pressures have risen across the Middle East and North Africa region on account of increasing energy and food prices. In the first quarter of 2011, Saudi Arabia's oil production increased as it used some of its spare capacity to compensate for the shortfall in Libyan oil output. In addition, private demand received a boost from the spending of a salary bonus given to public employees as part of a large fiscal package, but suffered somewhat from the increase in uncertainty. Consumer price inflation in Saudi Arabia was 5.0% year on year in the first quarter of 2011.

7.3 Commodity Markets

Oil prices posted strong gains in March 2011. Brent crude oil prices stood at USD 121.6 per barrel on 6 April 2011, which is 30.5% higher than at the beginning of the year. Looking ahead, market participants expect slightly lower oil prices in the medium term, with futures contracts for December 2012 trading at around USD 114.5 per barrel.

The increase in oil prices came against the background of escalating tensions in North African and Middle Eastern countries. The impact on the oil balance of the ongoing revolts in Libya has been substantial, given that the country's oil exports are virtually suspended. Saudi Arabia intervened to partially replace the lost Libyan production, but the intervention only managed to partially stabilize prices. These supply-side disruptions came against the background of very robust demand growth, both in emerging and developed economies, which makes the market balance currently very tight.

The prices of non-energy commodities declined slightly in March 2011. Food prices moderated somewhat on the back of positive expectations regarding the ongoing planting season. Metal prices also declined owing to the disruptions in industrial production that followed the Tohoku earthquake. In aggregate terms, however, the price index for non-energy commodities (denominated in US dollars) remained 2.6% higher at the end of March than at the beginning of the year.

7.4 Exchange Rate Developments

In March, the nominal effective exchange rate of the euro, as measured against the currencies of 20 of the euro area's most important trading partners, continued the appreciation that started in January 2011. As a result, on 6 April the nominal effective exchange rate of the euro was 3.9% higher than at the end of December 2010 and 2% above its average level for 2010.

In bilateral terms, during the first three months of 2011, the euro appreciated against most major currencies. Between 31 December 2010 and 6 April 2011, it strengthened against the Japanese yen by 12.1%, the US dollar by 7.0%, the Swiss franc by 4.7% and the Pound Sterling by 1.9%. The single currency also appreciated significantly vis-à-vis some commodity currencies (Australian dollar, Canadian dollar) as well as against major Asian currencies.

By contrast, the euro depreciated against the Hungarian forint and the Czech koruna by 5.3% and 2.5% respectively. The appreciation of the euro against the US dollar, combined with the corresponding strengthening against the currencies tied to the US dollar, accounted for almost 60% of the overall appreciation in effective terms. In March, following the Tohoku earthquake, foreign exchange markets experienced about of very high volatility, culminating with the Japanese yen reaching its historical high against the US dollar on 17 March, at JPY 78.85 per US dollar.

7.5 Impact of Global Economic Developments on the Ethiopian Economy

The expansion of global economy has continued to support the development of Ethiopia's external sector. For instance, earning from export of merchandise goods grew noticeably by 36.2 percent in annualized term in the third quarter of 2010/11 partly due to the rising of international commodity prices and the boost in volume of exports.

Likewise, the receipts from individual remittances and services exports surged remarkably during the third quarter of 2010/11 vis-à-vis the same quarter last year largely supported by the expansion of global economic activities in particular of the advanced nations. Estimated FDI inflows also improved significantly during the review period