I. OVERVIEW

International Economic Developments and their Impact on the Ethiopian Economy

World economic growth has slowed down somewhat in recent months. This mainly reflects a number of temporary factors, such as high commodity prices and supply-chain disruptions following the natural disaster in Japan. As the impact of these factors is gradually diminishing, the global recovery, which has become more self-sustained since the end of last year, is likely to regain momentum.

The US real GDP increased at an annual rate of 1.3% in the second quarter of 2011 (i.e. 0.3% on a quarter-on-quarter basis) following the annualized growth of 0.4% in the first quarter of the year. The Japanese economy continued to show signs of recovery, with an easing of the supply-side constraints triggered by the Great East Japan Earthquake. Industrial production increased by 3.9% month on month in June 2011, following the 6.2% growth in the previous month, implying that industrial production has recovered almost 66% of the losses arising from the earthquake. In the United Kingdom, according to the preliminary estimates, GDP growth declined to 0.2% in the second quarter, from 0.5% in the previous quarter, on a quarter-on-quarter basis. During the quarter, China's economy has continued to grow at a strong pace despite the ongoing tightening of monetary policy while India, another emerging country registered real GDP growth of 8.5% year-on-year in the second quarter of 2011, compared with 7.7% in the first quarter of 2011.

The momentum in economic recovery of the major advanced economies during the second half of 2011, gave better opportunity for external sector to flourish. Accordingly, Ethiopia's external sector has responded positively as revealed by remarkable improvement in current account balance including official transfer during the period witnessed by improvement in export earning proceeds, net service and net transfer accounts.

Macroeconomic Developments in Ethiopia

Inflation

During the fourth quarter of 2010/11, headline inflation surged to 13.8 percent against 1.7 and 8.9 percent in the same quarter last year and the previous quarter, respectively. Contributing 11.3 percent to the general CPI inflation, food inflation rate surged to 19.6 percent during the period and was the main factor behind the quarterly rise in headline inflation.

Monetary Developments

The stock of broad money supply (M2), measure of monetary aggregate in Ethiopia, stood at Birr 145.4 billion at the end of June 2011 revealing 11.6 and 39.2 percent quarterly and annual surge, respectively. Net foreign asset reached Birr 55.5 billion at the end of the fourth quarter of 2010/11, showing 21.7 percent quarterly and 104.2 percent annual increase whereas net domestic credit scaled up by 11.8 and 29.8 percent vis-à-vis end of June 2010 and end of March 2011 balance, respectively to reach Birr 135.6 billion. The surge in broad money supply both on quarterly and annual basis has been derived from the increase in net foreign asset and net domestic credit which counterbalanced the rise in net other items over the same period.

Reserve money scaled up by 8.5 and 69.0 percent on quarterly and annual bases, respectively and reached Birr 69.0 billion at the close of June 2011. Both currency in circulation and commercial banks' reserve at NBE surged over the same quarter last year and the previous quarter to press on reserve money. Money multiplier (broad money to reserve money ratio) increased by 2.8 percent from last year same period level but slightly declined by 0.4 percent against the previous quarter, revealing a decline of monetization.

Interest rate

As a result of the recent NBE's recent revision to raise minimum saving deposits rate by one percentage point from 4.0 percent to 5.0 percent per annum, average saving deposits rate reached 5.38 percent, up from 4.50 percent in the same quarter last year yet has remained unchanged vis-à-vis the previous quarter. Similarly, weighted average time deposits rate has remained unchanged from 5.38 percent during the previous quarter, but surged by about 0.88 percentage point vis-à-vis June 2010 level. The simple average lending rate however remained at 11.88 percent unchanged from previous quarter but declined from 12.25 percent a year ago.

Financial Sector Developments

With the opening of Addis International Bank S.C during the quarter, the total number of banks (including DBE) operating in the country reached 17 at the close of June 2011. Likewise, the number of insurance companies operating in the economy reached 14 with the opening of Berhan Insurance S. C during the quarter while the total number of MFIs remained at 31 during the quarter. Regarding branch network expansion, 104 new bank branches were opened in the review quarter taking the total bank branch network to 970 while 3 new insurance branches were opened by private insurance companies making total number of insurance branches 221 at the end of June 2011. As a result, bank branch to population ration reached 82,474[*] from 92,379 in the preceding quarter, reflecting an impressive performance in financial service outreach. Total capital of the banking sector reached Birr 15.9 billion (45.3 percent owned by private banks), up by 23.3 percent on annual comparison.

Resource mobilization of the banking system in the form of net change in deposits, loans collection and net borrowings increased by 76.9 percent vis-a-vis the corresponding quarter of last year though it has declined by 8.4 percent from the previous quarter to stood at Birr 21.5 billion at the end of June 2011. The quarterly decline in resources mobilization was due to the slowdown in net deposit mobilization by 28.8 percent that offsets the surge in collection of loans and net borrowing by 27.0 and 45.9 percent, respectively.

fresh loans disbursed by the banking sector during the review quarter was Birr 12.7 billion, up by 37.7 and 81.2 percent on quarterly and annual basis, respectively. Private Banks disbursed Birr 4.4 billion (35.0 percent) of the total fresh loans, almost unchanged from the previous quarter share revealing the decline in private banks new loans as their share was about 57 percent during the second quarter of 2010/11.

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[*] Computed based on the assumption that total population was 80 million

During the review quarter, commercial banks (including DBE) collected loans amounted to Birr 8.3 billion, up by 5.6 and 27.0 percent over the previous quarter and same quarter last fiscal year, correspondingly.   Private banks managed to collect Birr 4.4 billion or 53.5 percent of the total collection.

Outstanding credit of the banking system including claims on the central government but excluding corporate bond held by public enterprises and regional states reached Birr 77.7 billion, showing 24.7 and 5.5 percent annual and quarterly surge, respectively. The share of private banks in outstanding credit has declined slightly both on quarterly and annual comparison basically due to their higher loans collection rate and lower new loans disbursement during the quarter.

Total deposits mobilized by the banking system reached Birr 129.6 billion at the end of June 2011, revealing 42.5 and 8.5 percent annual and quarterly surge, respectively. The growth in deposit mobilization was attributed to the substantial expansion in branch networks during the quarter and improvement in economic activities. In the meantime, microfinance institutions mobilized Birr 3.8 billion deposits while their credit outstanding and total asset increased to Birr 7.0 billion and Birr 10.2 billion, respectively.

NBE's outstanding net claims on the government increased by 20.3 percent and 6.5 percent against last year and the preceding quarter, respectively, and reached Birr 55.3 billion.

External Sector and Foreign Exchange Developments

During the fourth quarter of 2010/11, merchandise goods export earnings was USD 870.6 million revealing 19.2 and 14.2 percent surge compared to the same quarter last fiscal year and the preceding quarter, respectively. The quarterly boost in earning from merchandise export was due to the surge in earnings from export of coffee (35.9 percent), gold (56.0 percent) and leather and leather products (17.5 percent) among others.

Total import of merchandise goods was USD 2,157.6 million during the fourth quarter, higher by 7.9 and 4.8 percent vis-à-vis the balance in the same quarter last year and the previous quarter, respectively. The quarterly surge of total imports of goods was on account of increase in imports of consumer goods (15.5 percent), raw materials (12.5 percent) and capital goods (10.1 percent) among others offsetting the slowdown in imports of fuel and semi-finished goods.

A net transfer from rest of the world was USD 1,309.9 million, up by 14.9 and 15.5 percent on annual and quarterly basis, respectively. The quarterly surge in net transfer was due to 71.6 percent increase in official transfer that counterbalanced the slight slowdown in private transfer by 2.3 percent.

Net service account indicated USD 95.4 million inflows during the quarter under review revealing a decrease of 58.8 percent against the previous quarter, but surged remarkable from -8.5 net inflows in the same quarter last fiscal year.

Current account balance (including official transfers) registered a surplus of USD 119.2 million against a deficit of USD 136.6 million last year same quarter. It revealed 187.2 and 74.6 percent annual and quarterly increases, respectively.

The official weighted average exchange rate of the Birr in the inter bank market was depreciated by 24.9 and 1.1 percent on annual and quarterly basis, respectively to reach Birr 16.9081/USD while the parallel average exchange rate weakened by 20.3 percent to Birr 17.0700/USD vis-à-vis the same period last year, but strengthened by about 0.2 percent compared to the previous quarter. Consequently, the average premium between the official and parallel market rates narrowed to 1.51 percent from 2.84 and 5.32 percent in the preceding quarter and same quarter last year, respectively.

Investment

A total of 1,150 investment projects with an aggregate capital of Birr 17.9 billion were licensed by the Ethiopian Investment Agency and Regional Investment Offices during the fourth quarter of 2010/11. The number of approved investment projects registered a 34 percent surge over the preceding quarter but scaled down by 33 percent vis-a-vis the corresponding quarter last fiscal year. The registered capital by the projects revealed a 25 and 89 percent annual and quarterly decrease

Fuel prices

During the quarter, the average international price of the crude oil reached USD 116.68 per barrel, up by 23.8 and 48.5 percent compared to the previous and last year corresponding quarter. Consequently, Addis Ababa average retail price of fuel has increased to Birr 17.7 per liter from Birr 14.9 in the previous quarter and Birr 11.1last year same period.

Federal Government Fiscal Operations

During the fourth quarter of 2010/11, revenues and grants collected by the Federal Government was Birr 19.6 billion, up by 32.9 and 17.3 percent compared to the same quarter last fiscal year and the previous quarter, respectively. The quarterly revenue and grant performance was 35.2 percent against the annual budget. A total of Birr 12.6 billion was collected in tax revenue, 25.4 and 9.0 percent surge on annual and quarterly basis, respectively. On the contrary, non-tax revenue showed a 36.9 percent annual slowdown but a surge of 3.9 percent quarterly to reach Birr 1.8 billon. Grants scaled up from Birr 3.4 billion in the previous quarter to Birr 5.2 billion in the review quarter.

Like wise, total federal government expenditures (including regional transfers) was Birr 22.0 billion showing 47.3 and 10.1 percent increase on annual and quarterly basis, respectively. Capital expenditure with share of 43.2 percent registered slight quarterly decline of 1.7 percent while both current expenditure and regional transfer have been surged during the period to cause overall quarterly increase in total expenditure.

The overall budget deficit (including grant) was Birr 2.4 billion, which was considerably lower than Birr 3.3 billion deficit registered in the preceding quarter. The deficit was financed from net external borrowing, privatization receipt and net domestic banking borrowing.