VIII. International Economic Developments[2]

8.1 Overview of the World Economy

Growth in the global economy has slowed in recent months, partly on account of temporary factors. While the unwinding of these factors should provide a boost to growth in the latter half of this year, the needs for further repair of public and private sector balance sheets as well as the continued weaknesses in housing and labour markets continue to restrain the strength of the recovery, particularly in advanced economies. Moreover, the renewed tensions in global financial markets and declining business and consumer confidence are further holding back the pace of the recovery. In emerging economies, growth has been moderating modestly, which should assist in alleviating overheating pressures in certain economies.

In the United States, the economic recovery gained momentum in the third quarter of 2011. US real GDP increased at an annual rate of 2.5% in the third quarter of 2011 (0.6% on a quarter-on quarter basis), up from 1.3% in the previous quarter. The expansion in the third quarter was supported by growth in consumer spending and business investment. The former increased at an annual rate of 2.4%, as durable goods purchases rebounded from a contraction in the previous quarter, which was partly related to the effects of the Japanese disaster. However, a coincident weakness in personal disposable income, which fell by 1.7% in real terms, and a drop in the personal savings rate to its lowest level since the last quarter of 2007 called into question the sustainability of the acceleration going forward. At the same time, business investment expanded at an annual pace of 16.3% and residential investment continued to recover modestly from very weak levels. Net exports contributed positively to GDP growth as export growth outpaced import growth, while inventories posted a strong negative contribution.

In Japan, economic activity has recovered significantly from the plunge triggered by the Great East Japan Earthquake, as supply-side constraints appear to have since eased considerably. As a result, economic growth in the third quarter of 2011 is largely expected to be fairly positive, after three

[2]Section 8.1 & 8.2 are excerpted from European Central Bank monthly bulletin October,, November & December 2011section 8.3,& 8.4 are excerpted from Oct. 2011.

quarters of negative growth. The pace of recovery, however, appears to have moderated somewhat from the rapid rebound immediately following the earthquake. After modest increases in July and August, industrial production declined by about 4% (month on month, seasonally adjusted) in September. This notwithstanding, real exports of goods increased by 3.4% in monthly terms (seasonally-adjusted) in September, following moderate increases in the two previous months, while real imports fell for the first time since March by 1.8% month on month.

In the United Kingdom, economic activity has remained relatively subdued recently. In the third quarter of 2011, real GDP increased by 0.5% quarter on quarter, largely reflecting the waning of some temporary factors in the second quarter of the year. The underlying growth momentum is likely to remain sluggish in the short term, even though monetary stimuli should support economic activity going forward. Growth in domestic demand is still expected to remain constrained by tight credit conditions, household balance sheet adjustment and substantial fiscal tightening, while the weakening of the outlook for external demand is likely to hinder export growth.

In the other non-euro area EU countries, the recovery has continued in recent quarters and growth remained robust in a number of countries in the third quarter of 2011, mainly on account of temporary factors (e.g. an increase in external demand and strong agricultural performance).

Looking ahead, growth prospects have deteriorated, partly reflecting spillover effects from the euro area and deteriorating external financing conditions.

In the largest central and eastern European countries, the recovery has continued in recent quarters. Looking ahead, however, growth prospects have deteriorated markedly, reflecting, in part, the weakening of activity in their main export markets in the euro area and worsened external financing conditions. Although quarter-on-quarter, real GDP growth accelerated to 0.6% in Hungary and 1.9% in Romania in the third quarter of 2011, this mainly reflected temporary factors (e.g. exceptionally strong agricultural performance). Real GDP growth stagnated in the Czech Republic in the third quarter of

2011, while in Poland, it remained robust at 1% quarter-on-quarter.

In the smaller central and eastern European countries, growth remained strong in the third quarter of 2011, but is expected to slow down in the coming quarters on account of the aforementioned factors. Growth has been mainly export driven in these countries, but the role of domestic growth drivers (e.g. private consumption) has also increased in spite of the high unemployment rates, in particular in Latvia and Lithuania.

In Russia, growth was rather robust in the third quarter of 2011, following the slowdown in the first half of the year. Year-on-year real GDP growth was 4.8% in the third quarter, after 3.7% on average in the first half of 2011. This was partly driven by strong growth in the agricultural sector. Industrial production growth continued to moderate, standing at 3.6% year on year in October 2011. Looking ahead, economic activity is likely to depend mostly on commodity price developments, given the important role played by energy commodity exports in the economy as well as on the impact of weakening global economic conditions.

The economic growth of emerging Asia stabilized in the third quarter of 2011 after moderating in the second quarter. Private consumption and investment continued to be resilient in a context of accommodative monetary policies and strong credit growth, while export growth decreased owing to the unfavorable external environment.

The economy of China has, thus far, been resilient to the worsening of the global outlook, with available evidence pointing to a soft landing in the coming quarters. In the third quarter of 201.1 real GDP increased by 9.1% year on year (down from 9.5% in the second quarter), with the contribution of domestic demand to growth diminishing and the contribution of net exports being negative. The process of appreciation of the renminbi against the US dollar has lost pace significantly since early September 2011, and a slight decrease in the stock of international reserves occurred in September owing to foreign exchange valuation effects. The People’s Bank of China kept its policy rates and reserve requirements unchanged amid ongoing inflationary pressures coupled with abundant domestic liquidity.

The real GDP growth of India decelerated to 6.7 % year-on-year in the third quarter of

2011 from 8.5% in the second quarter, mainly driven by the contraction in investment. In Korea, real GDP increased to 3.5% year on year in the third quarter of 2011, compared with 3.4% in the second quarter of 2011. The contribution of net exports and investment was weaker than in the previous quarter, while private consumption remained resilient, growing by 3.2% year on year.

Among the ASEAN-5 countries (Indonesia, Malaysia, the Philippines, Singapore and Thailand), Indonesia's economy continued to grow strongly (by 6.5% year on year in the third quarter of 2011), driven by private consumption and net exports. In Malaysia, Singapore and Thailand, GDP growth picked up in the third quarter of 2011, mainly owing to strong private consumption. At the same time, Thailand was experiencing its worst floods for more than 50 years, leading to severe disruptions in production. This will have had a negative impact on growth in the fourth quarter of 2011

Looking ahead, growth in emerging Asia is expected to remain moderate. The turmoil in global financial markets and weak activity in major advanced economies constitute downside risks to growth. As commodity prices are stabilizing, inflation is likely to decrease, reducing somewhat concerns about overheating risks.

In Latin America, growth in economic activity decelerated further in the third quarter of 2011. The growth moderation mainly stemmed from worsening global conditions and from the lagged effects of the tightening of domestic policies. In Brazil, there were widespread signs that the third quarter of 2011 saw an economic slowdown, with production, demand and labour market indicators worsening across the board. Industrial production was flat during that quarter of 2011. In Mexico, annual real GDP growth stood at 4.4% in the third quarter of 2011, compared with 3.6% in the previous quarter. Growth was supported to a significant degree by strong growth in the primary sector, which reflects a rebound from the weakness in the first half of the year. In Argentina, economic growth has started to decelerate after growing at a rapid speed during the past year and a half. Industrial production grew at an annual rate of 5.7% in the third quarter of 2011. This compares with 8.5% in the second quarter.

Looking ahead, growth in economic activity in emerging Asia region is expected to weaken further, mainly on account of a further slowdown in export growth. Inflationary pressures are expected to ease, albeit only gradually.

High energy prices and robust demand from emerging market economies continue to support GDP growth in those oil-exporting countries in the Middle East and Africa which have not witnessed major social unrest. In Libya, oil output is gradually rising, albeit so far mostly for domestic consumption.

In Saudi Arabia, oil production continued at historically high levels in the third quarter of 2011, partially to compensate for the shortfall in Libyan oil supply, but also in response to the strong demand from emerging markets. At the same time, the boost to consumer spending from the bonus given to public employees earlier in the year has faded.

The slow progress in the political transition and continued social unrest, as well as a weakening global economy, continue to hinder growth and macroeconomic stability in several oil-importing countries in the Middle East and North Africa. High global food and fuel prices and a severe drought in the Horn of Africa have led to a sharp increase in inflation in the region, which has required monetary tightening in a number of countries. Looking ahead, Middle East and Africa will be shaped by the scale of the slowdown in global activity and its impact on commodity prices.

8.2 Inflation Developments

Overall, annual headline inflation has stabilized in advanced economies, while inflationary pressures continue to be more pronounced in emerging economies. In the OECD area, annual headline consumer price inflation stood at 3.3% in September 2011, compared with 3.2% in August. Excluding food and energy, the annual inflation rate stood at 1.9% in September, compared with 1.8% in August. In emerging markets, inflation rates remain elevated on account of capacity constraints as well as the higher weight of commodities in these countries' consumption baskets.

In the United States, annual CPI inflation increased to 3.9% in September 2011, its highest level in three years, from 3.8% in the previous month. The increase in headline inflation in the course of 2011 continues to reflect a marked annual rise in energy and food prices, which increased at a rate of 19.3% and 4.7% respectively in the year up to September 2011. Excluding food and energy, annual inflation remained unchanged from the previous month and stood at 2% in September 2011, after having followed an upward trend for around a year. In part, the stabilization in annual core inflation reflected some moderation in the cost of motor vehicles and apparel, reversing the substantial increases recorded over previous months.

Annual CPI inflation in Japan declined in September 2011 to 0%, from 0.2% in the previous month. The annual CPI inflation, excluding fresh food, stood at 0.2% in September 2011, the same level as in August, while annual CPI inflation, excluding food and energy, increased to -0.4% from -0.5%.

In United Kingdom, annual CPI inflation has remained elevated in recent months. Inflation increased to 5.2% in September from 4.5% in August. The inflation of both energy and non-energy goods continued to accelerate and the jump in inflation was driven mainly by substantial increases in utilities prices. In the short term, inflation is likely to remain high but going forward, the gradual diminishing of certain temporary factors (higher past commodity prices, the lagged effects of the depreciation of the pound sterling and the increase in the rate of VAT in January 2011), as well as the existence of spare capacity, are expected to dampen inflationary pressures.

Annual HICP inflation has moderated steadily in recent months, standing at 3.8% in Hungary and 3.6 % in Romania in October 2011 partly owing to base effects and moderating commodity prices. HICP inflation increased slightly in the Czech Republic to 2.6% in October 2011 from a fairly low level compared with other countries in the region, while inflation in Poland, has been hovering between 3.5% and 4% in recent months. Looking ahead, changes in VAT and administered prices are expected to temporarily increase headline HICP inflation in these countries except Poland. Inflation has remained elevated (above 4%) in the Baltic countries and remained around 3% in Bulgaria. Looking ahead, inflation is expected to moderate owing to weaker growth and base effects.

In Russia, annual inflation has decelerated quickly since July 2011, and reached 6.8%

in November 2011. The Bank of Russia raised the rate on its deposit operations and reduced the rate on its repo operations in mid-September 2011, thereby narrowing the effective part of its interest rate corridor to 150 basis points in order to limit the volatility of inter bank market rates.

Annual inflation in emerging Asia is likely to have peaked in the third quarter of 2011 as both imported inflation and domestic demand pressures have eased more recently. In the light of signs of easing inflation and downside risks to the economic outlook, central banks in the region halted their monetary tightening cycle, except in some large countries where inflation remains stubbornly high.

In China, annual CPI inflation declined to 6.1% in September, only 0.1 percentage point down from August. The decrease in CPI inflation was mainly driven by food prices. Non-food CPI inflation also moderated slightly. In the property market, prices decelerated only marginally, despite the authorities' concerted efforts.

Annual wholesale price inflation – the Reserve Bank of India's preferred measure of inflation – has remained high, at 9.7% in September and October, with both manufactured products and commodity prices contributing to the high inflationary pressures. In Korea, annual CPI inflation was within the Bank of Korea's target band of 2% to 4% for the first time this year in October, falling to 3.9%, but has once more rebounded in November to 4.2%. The Bank of Korea maintained its policy rate at 3.25%.

In Latin America, inflationary pressures are easing somewhat, albeit remaining elevated across most countries in the region. In Brazil, inflationary pressures continue to rise with annual inflation reaching 7.1% in the third quarter of 2011, depicting 0.4 percentage points rise from the second quarter of 2011. In Mexico, annual consumer price inflation remained broadly unchanged compared with the preceding quarters, averaging 3.4% in the third quarter of 2011. In Argentina, inflation remains close to double digit rates, with annual CPI inflation standing at 9.8% in the third quarter of 2011, up by 0.1 percentage point compared with the second quarter.

In the third quarter of 2011, most oil-exporting countries experienced a slight pick-up in consumer price inflation, but overall inflationary pressures have remained subdued. In Saudi Arabia, consumer price inflation increased to 5% year on year in the third quarter from 4.7% in the preceding three months.

8.3 Commodity Markets

Oil prices decreased in September and early October. Brent crude oil prices stood at USD 100.7 per barrel on 5 October, which is still 8.1% higher than at the beginning of the year, but 12% lower than at the beginning of September. Looking ahead, market participants expect lower oil prices in the medium term, with futures contracts for December 2012 trading at around USD 96.1 per barrel

The decrease in prices came against the background of the intensification of the turbulence in financial markets and the associated concerns about the global economic outlook. Although, this has not yet affected current demand readings, especially in emerging economies; the International Energy Agency has cut back its demand projections for 2011 and 2012.

The prices of non-energy commodities decreased in the course of September. Both food and metal prices were negatively affected by concerns about the global economic outlook and its potential impact on commodity demand. In aggregate terms, the price index for non-energy commodities (denominated in US dollars) was 10.3% lower at the end of September than at the beginning of the year.

8.4 Exchange Rate Developments

From the end of June to early October 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, depreciated amid rather high volatility. On 5 October, the nominal effective exchange rate of the euro was 3.7% below its level at the end of June 2011 and 1.9% below its average level.

In bilateral terms, over the past three months, the euro has depreciated against most major currencies. Between 30 June and 5 October 2011, the euro declined against the Japanese yen (by 12.0%,) the Chinese renminbi (9.0%,) the US dollar (7.7%) and the pound sterling (4.4%). The Swiss franc, after having appreciated markedly until early September, now trades above the minimum exchange rate of CHF 1.20 per euro set by the Swiss National Bank and on 5 October stood at 1.6% lower than in late

June. The single currency appreciated strongly vis-à-vis some other European currencies, most notably the Polish zloty and the Hungarian forint, by 10.1% and 12.3% respectively. Market volatility, as measured on the basis of foreign exchange option prices, increased significantly in the course of the period under review in all currency pairs and currently stands well above long-term average levels.

Between July and September 2011, the Birr weakened with respect to major international currencies at different rates. For instance, as compared to the same period last year the Birr depreciated at faster rates against Swiss Frank (47%), Yen (29.1%) and Euro (28.3%), followed by SDR (23.2%), Pound Sterling (22.2%) and US dollar (17.2%) annually in the first quarter of 2011.

8.5 Impact of Global Economic Developments on the Ethiopian Economy

Even though, the global economic growth has slowed down in the review period while moderated in the emerging economies, the external sector of Ethiopia has continued to expand strongly year-on-year in the first quarter of 2011/12. Following, a – percent year-on-year export growth in the last quarter of 2010/11, export of merchandise export increased robustly by 33.7 percent in the first quarter of 2011/12 largely driven by international commodity price rise and expansion in volume of most export products. Likewise, private transfers from individuals and NGO’s surged by 43 percent (of which individual cash receipts rose by 52.5 percent) annually in the review period compared to – percent growth the preceding quarter. Estimated FDI inflows also expanded moderately by 16.2 percent in the first quarter of 2011/12 over the same period last year.