I. OVERVIEW

International Economic Developments and their Impact on the Ethiopian Economy

Growth of the global economy has scaled down in recent months, partially due to short-term 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 hold back the momentum of the recovery, predominantly in advanced economies. Furthermore, the renewed strains in global financial markets and declining business and consumer confidence are further holding back the pace of the revival. In emerging economies, growth has been moderating modestly, which should support in alleviating overheating pressures in certain economies.

US real GDP increased at an annual rate of 2.5 percent in the third quarter of 2011, up from 1.3 percent in the previous quarter. The expansion in the third quarter was supported by growth in consumer spending and business investment. In Japan, economic activity has recovered considerably 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 quite positive, after three quarters of negative growth. The pace of recovery, however, appears to have moderated somewhat from the rapid rebound immediately following the earthquake. In the United Kingdom, economic activity has remained relatively subdued recently. In the third quarter of 2011, real GDP increased by 0.5 percent quarter on quarter, largely reflecting the declining of some temporary factors in the second quarter of the year. In the third quarter of 2011, China's real GDP grew by 9.1 percent year on year (down from 9.5 percent in the second quarter), with the contribution of domestic demand to growth diminishing and the contribution of net exports being negative.

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. Export earned from 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.

Macroeconomic Developments in Ethiopia

Inflation

During the first quarter of 2011/12, general inflation slowdown to 6.6 percent against 13.8 in the previous quarter. About 80.0 percent of the quarterly inflation was contributed by food inflation rate, which was declined to 8.8 percent from 19.6 percent in the preceding quarter of 2010/11 while non-food inflation was declined to 3.2 percent from 5.8 percent in the previous quarter contributing just 20 percent in quarterly headline inflation.

Monetary Developments

The stock of broad money supply (M2), measure of monetary aggregate in Ethiopia reached Birr 150.8 billion at the end of September 2011 revealing 3.7 and 39.0 percent quarterly and annual surge, respectively. Net foreign asset reached Birr 55.5 billion at the end of the first quarter of 2011/12, indicating 46.0 percent annual surge but slight decline of 0.1 percent from the previous quarter. Net domestic credit has scaled up by 28.8 percent vis-à-vis the balance in September 2010 while slightly declined by 0.3 percent against June 2011 balance to reach Birr 135.1 billion. The surge in broad money supply on annual basis has been derived from the increase in net foreign asset and net domestic credit which counterbalanced the rise in other items net over the same period. Quarterly increase in broad money supply was due to 13.0 percent decline in other items net which offsets the decline in net foreign asses and domestic credit by 0.1 and 0.3 percent, respectively.

Reserve money scaled up by 27.8 percent on annual basis to reach Birr 68.1 billion at the close of the first quarter 2011/12. Both currency in circulation and commercial banks' reserve at NBE surged over the same quarter last year. On quarterly comparison, reserve money declined by 1.3 percent due to 0.94 and 1.85 percent slowdown in currency in circulation and banks deposit at NBE, respectively. The money multiplier, measured by the ratio of broad money to reserve money, increased marginally from 2.03 to 2.21 percent on annual basis implying the increased monetization of the economy.

Interest rate

Following the NBE's policy action that raised the minimum saving deposit rate from 4.0 percent to 5.0 percent, an increase by 25 percent effective from December 1, 2010 all banks have adjusted both their deposit and lending rates. As a result, the minimum and maximum saving deposit rates at the end of the quarter were 5.0 and 5.75 percent, respectively while the minimum and maximum lending rates stood at 7.5 and 16.25 percent. Considering 6.6 percent quarterly headline inflation, saving deposit rate is negative in real terms while lending rate is positive.

Financial Sector Developments

The total number of banks (including DBE) operating in the country remained 17 at the close of June 2011 unchanged from the previous quarter level. Likewise, the number of insurance companies operating in the economy was 14 unchanged from the previous quarter while the total number of MFIs remained at 31 during the quarter. Concerning branch network expansion, 47 new bank branches were opened in the review quarter taking the total bank branch network to 1017 while 6 new insurance branches were opened by private insurance companies making total number of insurance branches 227 at the end of September 2011. As a result, bank branch to population ration reached 78,663 from 82,474 in the preceding quarter, reflecting an impressive performance in financial service outreach. Total capital of the banking sector reached Birr 16.1 billion (45.4 percent owned by private banks), up by 21.6 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 25.8 percent vis-à-vis the corresponding quarter of last year but has declined by 13.2 percent from the previous quarter to reach Birr 18.7 billion at the end of the quarter under review. The quarterly decline in resources mobilization was due to the slowdown in net deposit mobilization by 37.7 and net borrowing by 10.2 percent that offsets the surge in collection of loans 18.4 percent.

Fresh loans disbursed by the banking sector during the review quarter was Birr 11.6 billion, registering 35.3 percent annual surge, but slowdown by 9.2 percent on quarterly comparison. Private Banks disbursed Birr 6.4 billion (55.5 percent) of the total fresh loans, unlike their lower share of 35.5 percent in the previous quarter revealing the fact that private banks new loans disbursement is not affected by the NBE bills as argued by many critics.

During the review quarter, commercial banks (including DBE) collected loans amounted to Birr 9.8 billion, up by 18.4 and 11.2 percent over the previous quarter and same quarter last fiscal year, correspondingly. Private Banks managed to collect Birr 4.2 billion or 42.9 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 84.6 billion, showing 34.7 and 15.0 percent annual and quarterly surge, respectively.

Total deposits mobilized by the banking sector during the quarter under review reached Birr 147.4 billion, up by 41.1 and 4.9 percent on annual and quarterly basis, respectively. The growth in deposit mobilization was partly attributed to the rise in the number of bank branches and improvements in economic activities. Similarly, microfinance institutions mobilized Birr 3.9 billion deposits while their credit outstanding and total asset increased to Birr 7.1 billion and Birr 10.2 billion, respectively at the close of the quarter under review.

External Sector and Foreign Exchange Developments

Total merchandise export proceeds during the first quarter of 2011/12 surged by 33.7 percent vis-à-vis the same period in 2010/11 and amounted to USD 753 million. The performance was attributed to higher earnings from export of gold, live animals, oil seeds, coffee, leather & leather products, meat & meat products, flower, chat and fruit & vegetables due to rising in international price of commodities and the expansion of the volume of most products.

During the first quarter of 2011/12, total merchandise import grew by 27.4 and 5.9 percent on annual and quarterly basis to USD 2.3 billion. Increased imports of fuel (57.4 percent) semi-finished goods (43 percent), raw materials (40 percent and consumer goods (50.5 percent) accounted for annual performance of total.

Total net transfer receipts during the review period stood at USD 1.37 billion grew by 34.3 percent relative to the same period last year largely, due to the surge in total private transfer receipts.

Net service account recorded USD 121.8 million net receipts during the first quarter of 2011/12, declined sharply by 49.6 percent with respect to the same period last year.

During the first quarter of 2011/12, current account (including official transfers) registered 48.5 million deficits against the surpluses of USD 25.2 million last year same period and USD 153.7 million in the preceding quarter.

During the first quarter of 2011/12, the average exchange rate of the Birr in the inter-bank foreign exchange market stood at Birr 17.0011/USD, showing quarterly and annual depreciations of 1.1 and 16.8 percent, respectively. In the parallel market it depreciated by 16.1 percent vis-à-vis last year and 1.9 percent against the preceding quarter to reach Birr 17.39/USD during the review period. Consequently, the average spread between the official and parallel market exchange rates slightly narrowed to 2.3 percent compared to 3 percent the same period last year, mainly due to a relatively faster rate of deprecation of the official exchange rate.

Investment

During the first quarter of 2011/12, the Ethiopian Investment Agency and Regional Investment Offices licensed a total of 1,175 investment projects with an aggregate capital of Birr 30.4 billion The number of approved investment projects was 48.8 percent lower relative to same period of last year but marginally higher by 2 percent against the preceding quarter. Similarly, the total registered capital of these projects declined by 22 percent annually while grew by 69 percent on quarterly basis.

Fuel prices

During the review quarter, the average international price of the crude oil was USD 103.04 per barrel, down by 11.7 percent compared to the previous quarter. However, Addis Ababa average retail price of fuel has remained to be Birr 17.7 per liter during the quarter.

Federal Government Fiscal Operations

Total federal government revenue and grants reached Birr 20.8 billion during the first quarter of 2011/12, up by 43.9 percent on annual and 6.2 percent on quarterly basis. The quarterly revenue and grant performance was 23.1 percent of the annual budget. Of the total revenue mobilized during the first quarter of 2011/12, about 99.8 percent was obtained domestic sources.

Total federal government expenditure, including regional transfers, stood at Birr 19.8 billion during the period under review. Compared to a year a go, total expenditure went up 20.5

percent owing to rise in current expenditure (31.9 percent), regional transfer (28.9 percent) and capital expenditure (10.9 percent).

As a result of improvement in domestic revenue mobilization, the federal government budgetary operations (including grant) depicted an overall surplus of Birr 1.03 billion contrary to Birr 1.95 billion deficits a year earlier. Accordingly, there was net repayment to the domestic banking system.