

VIII. International Economic Developments

8.1 Overview of the World Economy⁸

Although global economic activity is continuing to recover gradually, it remains heterogeneous across economic regions, with growth momentum firming up in advanced economies but losing some vigor in emerging markets. The gradual pick-up in advanced economies' output growth was underpinned by strengthened short-term prospects in the United Kingdom and relatively robust economic activity in the United States and Japan. In the emerging markets, China's growth appears to have regained some traction in the third quarter on the back of a modest policy stimulus, but in most other emerging countries economic activity continues to be muted, hampered by structural impediments and tighter financial conditions.

In the United States, real GDP growth accelerated in the second quarter of 2013. According to the Bureau of Economic Analysis' final estimate, real GDP increased at an annualized quarterly rate of 2.5 percent, up from 1.1 percent in the first quarter. Real GDP growth was sustained by

gains in personal consumption expenditure, although these gains were slower than in the first quarter, and by both non-residential and residential strong private fixed investment. The change in inventories added an annualized 0.4 percentage point to growth. By contrast, government consumption continued to be a drag on activity, although the decline in the second quarter of 2013 was relatively small, following two consecutive quarters of substantial declines. The contribution of net exports to GDP growth was slightly negative, reflecting buoyant export and import growth. However, high frequency data suggest that economic activity continued to expand moderately in the third quarter. Retail sales, industrial production and construction spending, as well as measures of consumer and business sentiment, were generally higher in the third quarter than in the second, pointing to continued expansion in consumer spending and private fixed investment. The employment report for September confirmed some loss of momentum in job creation in the third quarter. While, the unemployment rate declined further by 0.1 percentage points to

⁸Sections 8.1 – 8.4 are excerpted from European Central Bank monthly bulletin of September, October & November 2013.

7.2 percent, average job gains in the third quarter have slowed from the average increases recorded in the first half of the year.

In Japan, the latest economic data suggest that the Japanese economy expanded during the third quarter, although the pace of growth may have slowed. On the domestic side, industrial production rose by 1.5 percent month on month in September, following a 0.9 percent decline in August. Recent sentiment indicators also point to a further expansion in output during the third quarter. The trade deficit widened further during the third quarter, with real exports and imports of goods registering a contraction of 1.1 percent and an expansion of 2.5 percent respectively.

In the United Kingdom, economic activity has recently seen strong growth, although spare capacity remains high and the outlook for growth continues to be uncertain. Real GDP increased by 0.8 percent quarter on quarter in the third quarter of this year, according to the preliminary estimate. This increase was mainly due to growth in the services sector, although the industrial and construction sectors also made positive contributions. The labor market situation has continued to improve gradually, with

employment growth picking up in recent months. The unemployment rate has also fallen recently, albeit remaining relatively high at 7.7 percent in the three months to August.

In China, survey indicators and data continued to point to a recovery of the growth momentum. Economic growth in the third quarter accelerated to 7.8 percent year on year, from 7.5 percent in the second quarter, on the back of the implementation of a small stimulus package. Growth was mainly driven by higher investment and, to a lesser extent, consumption. While fixed-asset investment and industrial profit growth declined somewhat in September, growth in industrial production and retail sales remained strong. Overall, activity continues to be supported by buoyant credit and loan growth, which has remained well above nominal GDP growth, although it decelerated somewhat further in September. In the largest central and eastern European (CEE) EU Member States, economic activity has picked up. According to preliminary data, in the second quarter of 2013 real GDP increased in the Czech Republic, Hungary, Poland and Romania. In Turkey, real GDP increased by 1.6 percent quarter on quarter in the first quarter

of 2013, supported by domestic demand. In contrast, in Russia, output declined by 0.1 percent quarter on quarter in the first three months of the year, with investment and net exports making negative contributions to growth.

In Middle East and Africa, in the first half of 2013 economic activity in oil exporting economies remained robust. Despite supply disruptions in some countries and weaker demand for OPEC oil, growth was supported by high oil prices, strong government spending and the robust performance of the non-oil private sector. By contrast, Arab countries in transition faced renewed bouts of instability, which dampened output and further delayed necessary reform. Elsewhere in the region, growth was sustained at comparatively high levels, notwithstanding headwinds from weak external demand and lower non-oil commodity prices.

Economic activity in Latin America continued to recover to some extent in the first half of 2013, although the recent tightening of financial conditions is expected to have dampened the growth momentum somewhat. The recovery has been driven by domestic demand, whereas net exports continued to act as a drag on

growth. Looking ahead, economic performance in the region is expected to benefit from the gradual strengthening in external demand and the lagged effects of the past monetary policy easing in major economies, particularly in Brazil, and the implementation of structural reforms in Mexico. However, potential growth is expected to be somewhat lower than previously thought in a number of countries, especially in Brazil, following a prolonged period of weak investment.

8.2 Inflation Developments

Overall, global inflation remains contained, on account of prevailing spare capacity in advanced economies. In the OECD area, consumer price inflation was 1.5 percent year on year in September 2013, compared with 1.7 percent in August. This decline was driven by markedly lower energy price inflation and a slight decrease in food price inflation. Excluding food and energy, in September the OECD annual inflation rate remained stable at 1.6 percent. The decline in annual headline inflation was observed in most OECD countries and large emerging economies, with the exception of Japan and China, where it increased.

In United States, annual CPI inflation declined further by 0.3 percentage point to 1.2 percent in September, in part owing to strong base effects in energy prices over the past two months, which led to a swing in the year-on-year growth rate of energy costs from +4.7 percent in July to -3.1 percent in September. Food price inflation remained stable at 1.4 percent. Excluding food and energy, core inflation eased slightly to 1.7 percent, from 1.8 percent in August, supported by continued growth in shelter and medical services prices.

In Japan, consumer price inflation has maintained its upward trend since the beginning of the year, with the headline index moving into positive territory in June 2013. Annual consumer price inflation increased to 1 percent in September from 0.9 percent in August. At the same time, annual core inflation (excluding food, beverages and energy) remained at 0 percent in September, unchanged from August. The recent upward trend in inflation follows the depreciation of the yen against the currencies of its main trading partners earlier this year.

In United Kingdom, annual CPI inflation has been relatively high in recent months. In September 2013 the headline inflation rate

remained stable at 2.7 percent, with lower energy price inflation being offset by higher inflation in the volatile airfare services component. Looking ahead, it is expected that inflationary pressures will be dampened by existing spare capacity in labor and capital utilization in the medium term. However, rises in administered and regulated prices, as well as the need for companies to restore their profit margins, could put some upward pressure on inflation.

In China, largely as a result of strong increases in the (volatile) food price component, CPI inflation increased in September to 3.1 percent, although it remains below the authorities' 3.5 percent target for 2013. PPI inflation has remained in negative territory since March 2012.

In central and eastern European (CEE) EU Member States, annual HICP inflation has, on average, stayed low in the largest CEE countries over the past few months. Inflation has been dampened by low commodity price inflation and favorable base effects stemming from previous increases in indirect tax and administered prices, as well as subdued domestic demand pressures.

In Turkey, annual CPI inflation has risen considerably since May, partly as a result of

the weakening Turkish lira. In Russia, inflation declined over the same period on account of lower food prices, but remains above the Bank of Russia's target range for 2013.

8.3 Commodity price

Brent crude oil prices have increased by 14 percent since the beginning of June 2013. After trading between USD 100 and USD 106 per barrel since mid-April, Brent crude oil prices rose in early July to reach USD 115 per barrel on 4 September. The rise in oil prices was due to a combination of intensifying geopolitical tensions, a decline in OPEC supply and stronger oil refinery demand. On the supply side, the developments in Egypt and Syria lifted oil prices higher owing to concerns about potential supply disruptions. These concerns came against a background of supply reductions in Libya, Iraq and Nigeria which could not be offset by higher oil production in Saudi Arabia, leading to a fall in overall OPEC supply. On the demand side, stronger than expected global oil refinery demand, mainly driven by non-OECD countries, put further upward pressure on oil prices.

Amid some volatility, prices of non-energy commodities have fallen by 1.5 percent on aggregate since the beginning of June. The

decline was broad-based but stronger in food commodities, as grain prices in particular fell sharply owing to favorable supply prospects. In aggregate terms, the price index for non-energy commodities (denominated in US dollars) was about 7 percent lower at the end of August 2013 compared with the same period a year earlier.

8.4 Exchange Rate Developments

Over the third quarter the effective exchange rate of the euro has appreciated slightly in an environment of low volatility. Movements in exchange rates were largely related to changing market expectations about the economic outlook for the euro area relative to other major economies, as well as developments in interest rate expectations. As a result, the euro appreciated slightly in early June, but weakened during the second half of the month and early July, before appreciating again until late August.

In bilateral terms, over the quarter three months the euro has strengthened against the US dollar (by 1.3 percent) and the Japanese yen (by 0.5 percent) but has depreciated against the pound sterling (by 0.9 percent). The euro also strengthened against most

other European currencies and against the currencies of commodity-exporting countries and emerging economies in Asia.

With regard to indicators of the international price and cost competitiveness of the euro area, in August 2013 the real effective exchange rate of the euro based on consumer prices was 6.9 percent above its level one year earlier. This largely reflected the nominal appreciation of the euro since then, which was only partly offset by a lower rate of consumer price inflation in the euro area compared with its main trading partners.

8.5 Impact of Global Economic Development on Ethiopian Economy

During the period under review, the global economic activity was gradually recovering. This had to some extent affected the external sector of Ethiopia. Official transfers during the first quarter of 2013/2014 jumped by 203.4 percent compared to last year same period. Also, the receipt from export of services improved by 9 percent vis-à-vis last year same period. Private transfers raised by 4.6 percent during the first quarter of 2013/14 compared to last year same period. FDI also increased by 9.4 percent in relation to last year same period.

However, the recovery of the global economy had not yet taken effect in Ethiopia's export performance. Compared to last year same period, exports have declined by 9.6 percent. A fall in the prices of major export commodities of the country in the international market and decline in the production of some of the export commodities are among the major factors that explain this decline.

On the other hand, imports have risen by 7.1 percent vis-à-vis last year same period mainly driven by higher fuel import bill due to an upward movement in international oil price and increased fuel demand of the country. Consequently, balance of payments deficit widened in relation to the preceding quarter and the same period last year.