I. OVERVIEW

1.1 International Economic Developments[1]

According to European Central Bank monthly bulletin of September, October & November 2013, though 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 energy 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

[1] Excerpted from European Central Bank monthly bulletin of September, October & November 2013

0.1 percentage points to 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 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 the 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.

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

1.2 Macroeconomic Developments in Ethiopia

Inflation

During the first quarter of the fiscal year 2013/14, headline inflation surged to 4.1 percent vis-à-vis 2.2 percent in the preceding quarter and 3.2 percent point last fiscal year same quarter. Quarterly food & non-alcoholic beverage inflation was 4.7 percent in the reviewed quarter up by 2.3 and 1.7 percentage points compared to the previous quarter and same quarter of last year, respectively. Core inflation, on the other hand, scaled up to 3.4 percent from 2.1 percent in the fourth quarter of 2012/13.

In the reviewed quarter, food & non-alcoholic beverages contributed 2.5 percent to the quarterly headline inflation of 4.1 percent while that of core inflation was 1.6 percent.

Fuel prices

During the first quarter of 2013/14, the price of crude oil in the international market reached USD 105.8 per barrel; about 12.3 and 14.8 percent higher than USD 94.2 and USD 92.2 per barrel in the preceding quarter and a year ago respectively. However, domestic retail prices of petroleum products in Addis Ababa remained unchanged at Birr 16.8 per liter against the preceding quarter. The price of ethanol mixed benzene stood at Birr18.8/ liter during the review period.

Monetary Developments

At the end of the quarter under review, broad money supply (M_2) reached Birr 237.2 billion registering a quarterly growth rate of 0.8 percent and 23.5 percent annual expansion. The surge in broad money was largely due to the rise in domestic credit where stronger growth in claims on non-central government took the lion's share.

Net foreign assets of the banking system scaled down by Birr 7.3 billion or 16.0 percent compared to the previous quarter but the drop was comparatively small against the corresponding quarter in 2012/13. The fall in net foreign assets restrained the growth in broad money supply.

Domestic credit witnessed 1.7 percent quarterly and 28.4 percent annual growth driven by a surge in credit extended to non-government sectors. Claims on government sector increased by 30.9 percent compared to the same quarter in 2012/13 though it shrunk by 1.8 percent in contrast to the preceding quarter.

Reserve money, which comprises currency in circulation and bank deposits at NBE, increased by 7.7 percent on annual basis while it contracted by 4.8 percent compared to the previous quarter. The reason for the fall in reserve money relative to the preceding quarter was attributed to Birr 4.3 billion or 7.9 percent decline of currency in circulation that more than offset the effect of a Birr 750 million or 3.8 percent rise in banks' reserve at NBE.

Determinant wise, net foreign assets of the National Bank of Ethiopia declined by 5.0 percent in contrast to the previous quarter, at the same time its domestic credit to the central government declined by 10.1 percent as a result of the buildup in government deposit by Birr 7.4 billion.

Meanwhile, excess reserves of commercial banks reached Birr 10.4 billion at the end of the quarter recording a substantial improvement both over the previous quarter and the corresponding quarter of last year.

Interest rate

Average saving deposit and lending rates remained unchanged at 5.4 and 11.88 percent, respectively, both on quarterly and annual basis. Weighted average time deposit rate, however, registered annual increment of 3.0 percentage point. On the other hand, the weighted average yield on T-bills slightly increased from 1.96 percent to 2.15 percent on annual terms. However, considering annual headline inflation of 7.4 percent during the quarter under review, all deposit rates and T-bills yields were negative whereas the average lending rate was positive in real terms. The spread between deposit rate and lending rate of commercial banks was about 6.5 percent on average.

Financial Sector Developments

Banks, insurance companies and microfinance institutions are the main financial institutions in Ethiopia. The number of banks operating in the country reached 19 by end September 2013 of which 16 banks were privately owned.

During the review quarter, 108 new bank branches were opened there by raising the total number of bank branches to 1,832. As a result, the ratio of total bank branch to total population went down to 46,888.6[2] from 49,826.0 in the preceding quarter, indicating a significant improvement in financial service outreach.

About 33.5 percent of the total bank branches were located in Addis Ababa, which describes a relatively high concentration of branches in the capital. Of the total bank branches, the share of the private banks increased marginally to 50.1 percent from 49.8 percent in the preceding quarter due to the opening of 60 new branches by private banks surpassing 48 new branches opened by public banks during the review quarter.

Meanwhile, the total capital of the banking system reached Birr 24.2 billion at the end of the first quarter of the fiscal year 2013/14, of which 48.3 percent was ascribed to private banks. Commercial Bank of Ethiopia, the biggest state owned bank, accounted for 37.4 percent of

[2] Computed based on the assumption that total population was 85.9 million

the total capital of the banking system while the share of Development Bank of Ethiopia and Construction and Business Bank of Ethiopia was 14.3 percent in total.

The number of insurance companies operating in the country reached 17 during the review quarter, of which 16 were private. The number of insurance branches increased to 284 from 252 last year. Of the total branches, about 54.6 percent were located in Addis Ababa, showing relatively high concentration of insurance services in the capital city.

During the review quarter, the total capital of the insurance industry increased by 39.2 percent on annual basis and reached Birr 1.6 billion. The capital share of private insurance companies stood at 76.9 percent.

On the other hand, there are 31 micro-finance institutions (MFIs)[3] operating in the country. These MFIs mobilized a total saving deposit of Birr 7.8 billion, which is 37.5 percent higher than last year the same period. Similarly, outstanding credit of the MFIs scaled up by 38.4 percent on annual basis and reached Birr 13.6 billion. Likewise, their total assets increased by 36.1 percent to Birr 18.6 billion by the end of September 2013.

Total resources mobilized by the banking system (as measured by the sum of net change in deposit, loans collected and net change in borrowings) declined by 64.0 percent against the preceding quarter due to a slowdown largely in net change in deposits and net change in borrowing by 111.8 percent and 77 percent, respectively. Likewise, year-on-year basis, total resources mobilized by the banking system decreased by 29.3 percent due to a 148.9 percent drop in net change in deposits and 59.8 percent in net change in borrowings.

Total disbursement of fresh loans by the banking system was Birr 9.6 billion, indicating a decrease of 28.4 and 3.0 percent compared to the preceding quarter and the same period of last year, respectively. Public banks disbursed Birr 4.9 billion (51.0 percent) and private banks the remaining balance. About 99.9 percent of new loan disbursement by private banks went to

[3] Gambella MFI is inactive at present

private enterprises while 52.0 percent and 31.9 percent of the loan by public banks were disbursed to private enterprises and state enterprises, respectively.

Sector wise, industry was the largest beneficiary of bank loans accounting for Birr 2.8 billion (29.1 percent) followed by domestic trade (Birr 2.1 billion or 21.6 percent), housing and construction (Birr 1.3 billion or 13.3 percent), international trade (Birr 1.1 billion or 11.9 percent) and agriculture (Birr 994 million or 10.4 percent).

During the review period, the banking system collected Birr 12.3 billion, reflecting a 7.1 percent contraction against the preceding quarter. Of the total loan collected, private banks' share was Birr 5.4 billion (44.1 percent) and that of public banks was Birr 6.9 billion (55.9 percent). Of the total loan collection, 61.9 percent was from private enterprises followed by cooperatives (27.9 percent) and public enterprises (10 percent).

Total outstanding credit of the banking system (excluding credit to the government) reached Birr 135.3 billion at the end of September 2013, down by 0.4 percent against the preceding quarter. About 95.0 percent of outstanding loan of private banks was a claim on private enterprises 4.0 percent on central government and 0.8 percent on cooperatives. Concerning public banks, 41.2 percent, 46.5 percent and 11.7 percent of the total outstanding loan was claims on state enterprises, private enterprises and central government respectively.

Sector wise, outstanding credit to industrial sector stood at Birr 51.1 billion (34.3 percent) followed by international trade (Birr 25.0 billion or 16.8 percent), housing & construction (Birr 17.1 billion or 11.5 percent), agriculture (Birr 14.2 billion or 9.6 percent) and other sectors the remaining balance. The share of private banks in total outstanding loan stood at 32.2 percent compared to 33.6 percent a quarter earlier.

External Sector and Foreign Exchange Developments

Total merchandise exports declined by 25.6 percent and 9.6 percent on quarterly and annual basis, respectively and reached USD 631.1 million. The quarter-on-quarter decline in export revenue resulted from the fall in the export earnings from coffee (40.6 percent), gold (48.7 percent), oilseeds (39.5 percent), pulses (24.4 percent), flower (23.5 percent), leather & leather products (4.1 percent) and fruits & vegetables (11.2 percent). The decline in these export earnings was attributed to lower export volume, prices or both.

The global coffee price continues to show no sign of recovery. The International Coffee Organization (October 2013) report indicated that the monthly average ICO composite indicator price now stands at its lowest level since March 2009. This adversely affected our export of coffee to the global market. As a result, the value of export of coffee in the first quarter of 2013/14 went down to USD 137.3 million from USD 199.3 million and USD 231.1 million in the first quarter of 2013/14 and same quarter last year, respectively.

During the review quarter, the unit value of coffee fell by 19.0 and 1.1 percent on annual and quarterly basis, respectively. As a result of the current dismal global coffee market condition, the volume of coffee export in the review period dropped significantly by 39.9 percent and 15 percent vis-à-vis the previous quarter and last year same quarter, respectively. The share of coffee export proceeds in the total export earnings declined to 21.8 percent from 28.6 percent in the first quarter of last year and 27.3 percent in the preceding quarter.

The total merchandise import during the first quarter of 2013/14 was USD 2.9 billion which went up by 9.4 percent compared to the previous quarter owing to the rise in imports of consumer goods (13.2 percent), fuel (25.6 percent), semi-finished goods (9.4 percent) and raw materials (15.4 percent). In the meantime, imports of capital goods went down by 5.5 percent, particularly due to the fall in imports of industrial goods (16.2 percent). Similarly, fertilizer import decreased by 88.4 percent over the preceding quarter. With respect to last year same quarter, however, total import increased by 7.1 percent mainly due to the rise in the value of import of consumer goods (5.2 percent), fuel (21.9 percent) and semi-finished goods (13.7 percent). The rise in import value of consumer goods, in turn, was attributed to a 29.1 percent rise in import of durable consumer goods**.**

The net receipt from services trade stood at USD 225.5 million, up from USD 140.6 million last year same period. This was attributed to the rise in net transport services (48.2 percent), government services (22.4 percent) and fall in net payments to other services (42.1 percent), mainly construction service (80.1 percent).

The current account balance (including official transfers) registered USD 602.6 million in deficit during the first quarter of 2013/14, which was lower than USD 824.5 million deficit recorded a year ago. The fall is attributed to the rise in net services (60.4 percent), private transfers (5 percent) and official transfers (192.7 percent).

In the review period, the capital account recorded USD 538.7 million in surplus, about 29.6 percent higher than that of last year same period. This was due to the rise in foreign direct investment (9.4 percent) and other public long term capital.

During the first quarter of 2013/14, the average official exchange rate of the Birr in the interbank foreign exchange market depreciated by 4.9 percent and 1.1 percent compared to last year same period and the preceding quarter, respectively, to reach Birr 18.7384/USD. Likewise, the parallel market exchange rate depreciated by 7.2 percent relative to a year ago but appreciated by 2.2 percent over the preceding quarter and stood at Birr 19.7633/USD. Consequently, the premium between the official and parallel market rates in the stated periods widened to 5.5 percent from 3.2 percent in same quarter last year but narrowed compared to 9 percent in the previous quarter.

Federal Government Fiscal Operations

The total revenue and grants mobilized during the first quarter of 2013/14 amounted to Birr 28.7 Billion, which was about 26.1 percent of the total annual budget. The total revenue was Birr 28.6 Billion, of which Birr 24.4 Billion (85 percent) was obtained from tax revenue while non tax revenue was Birr 4.3 billion (15 percent). Grants and relief obtained during the review period amounted to Birr 44.2 million.

During the review quarter, total revenue and grants showed a 22.2 percent increase compared to the preceding quarter and 5.6 percent over the same period last year. On the other hand, quarterly federal government expenditure was Birr 29.8 billion which was 39.2 percent higher than a year ago.

Hence, overall fiscal balance (including grants) of the Federal government depicted an overall deficit of Birr 1.1 billion during the period under review compared to Birr 5.7 billion deficit last year.