I. OVERVIEW

1.1. International Economic Developments

The global recovery remains steady and diverse. Following some temporary weakness in the first quarter of 2014, global activity recuperated some vigor in the second quarter. This was supported by a strong rebound in the United States, real GDP increased at annualized rate of 4.0 percent (1.0 percent quarter on quarter-on-quarter)as the temporary factors that had unfavorably affected the economy at the beginning of the year diminished. Likewise, economic activities in the United Kingdom continued to maintain a strong momentum in the second quarter, supported by a rising household confidence and an optimistic housing market. Moreover, growth in China also recovered following the fiscal policy stimulus and a further rise in credit. By contrast, activity in Japan moderated after the VAT increase in April, but highly expansionary monetary policy continues to support the resurgence. Economic activity in Russia was severely dampened owing to geopolitical tensions, which has also had some adverse consequences on the central and eastern European region.

In Japan, after a moderately solid performance at the start of 2014, the latest economic indicators confirm that economic activity in the second quarter of this year is likely to have contracted, as private demand rebalanced following the VAT increase in April and the frontloaded spending in the first quarter. After a pronounced drop in April, real private consumption recovered moderately in the following months, while industrial production fell again in June. At the same time, private core machinery orders declined markedly in May, and real exports of goods fell significantly in both May and June, pointing to some weakness in private non-residential investment and exports in the second quarter.

Economic activity in the United Kingdom continued to maintain a strong momentum in the second quarter of 2014. According to preliminary data, real GDP growth remained at 0.8 percent quarter on quarter. Activity was mostly floated by growth in the services sector, but the production sector also made a positive contribution. While a breakdown of demand components is not yet available, high frequency data suggest that economic activity has been supported by the buoyant housing market and strong private consumption.

Growth in China picked up in the second quarter as fiscal stimulus, a surge in credit and stronger external demand contributed to a swift turnaround in activity. Real GDP growth was to7.5 percent annually in the second quarter of 2014 from 7.4 percent in the previous quarter. On a quarterly basis, growth accelerated to 2.0 percent from 1.5 percent in the preceding quarter. The strong credit expansion fuelled investment, which contributed most to growth, while the contribution from net exports became positive for the first time since early 2013. Overall, however, the expansion of external trade – albeit recovering after a very weak start in the year – remains very modest from a historical perspective. At the same time, risks stemming from the housing market seem to be diminishing: after a steep fall earlier in the year, the decline in housing sales has bottomed out recently, as buyers take advantage of price cuts by developers.

During the review quarter, the gradual and diverse global economic upturn to some extent affected the external sector of Ethiopia. While export increased by 14.8 percent due to increased value and volume of major export commodities, net private transfers raised by 38 percent compared to last year same period. The net capital inflow also has increased by 168.1 percent on account of rise in inflows of net official long- term capita (8.4 percent), foreign direct investment (69.8 percent) and other public long term capital.

On the other hand, imports have risen by 35.7 percent vis-à-vis last year same period mainly driven by larger values of capital goods, consumer goods and semi-finished goods as well as higher volume of fuel import due to increased fuel demand of the country.

1.2. Macroeconomic Developments in Ethiopia

Fuel prices

During the fourth quarter of 2013/14, the average price of Brent Crude Oil, used as a point of reference for international oil price, stood at USD 109.8 per barrel compared with USD 103.01 and USD 107.93 per barrel recorded in the previous year same quarter and the preceding quarter, respectively.

Following the movements in the international oil prices and other domestic factors, domestic retail prices have been adjusted. Accordingly, average retail price of fuel in Addis Ababa rose to Birr 18.83 per liter; showing an average increment of 11.9 and 1.7 percent over the same quarter of last year and the preceding quarter, respectively.

Inflation

During the review quarter, headline inflation has surged to 2.8 percent from 0.4 percent in the previous quarter on account of 6.0 percentage point rise in food & non-alcoholic beverages inflation offsetting a decline in non-food inflation by 1.4 percentage point. Quarterly food & non-alcoholic beverage inflation turned up to 3.9 percent from -2.1 percent below zero during the previous quarter. Unlike food and non-alcoholic beverage inflation, non- food inflation scaled down to 1.7 percent from 3.1 percent over the same period. Of the 2.8 percent quarterly headline inflation, food & non -alcoholic beverage inflation accounted for two percent while non- food inflation contributed the remaining 0.8 percent.

Monetary Developments

Broad money supply (M_2) reached Birr 297.7 billion at the end of the fourth quarter of 2013/14, revealing quarterly growth rate of 8.9 percent and 26.5 percent surge on annual basis. The annual expansion in broad money was mainly driven by 28.4 percent growth in domestic credit. The annual growth in domestic credit was due to 29.2 percent increase in credit to non-central government and 21.2 percent rise in net credit to central government.

Reserve money reached Birr 89.0 billion at the end of the fourth quarter of 2013/14, depicting an annual increment of 18.7 percent and quarterly growth of 5.2 percent. Similarly, excess reserves of commercial banks increased by 5.9 and 0.6 on annual and quarterly bases, respectively.

The money multiplier measured by the ratio of broad money to reserve money, grew by 3.1 percent on annual basis implying the improvement in monetization of the economy.

Interest rate

Average savings deposit and lending rates remained unchanged at 5.4 and 11.88 percent, respectively, throughout the year. Weighted average time deposit rate, however, slightly declined by 0.1 percentage point on annual bases to reach 5.66 percent. On the other hand, weighted average yield on T-bills decreased to 1.33 percent during the fourth quarter from 1.86 percent a year ago.

Considering annual headline inflation of 8.5 percent in June 2014, all deposit rates and T-bill yield remained negative while average lending rate was positive in real terms.

Financial Sector Developments

Banks, insurance companies and microfinance institutions are the main formal financial institutions operating in the Ethiopian economy. The number of banks in the country was 19 as of end June 2014, of which 16 banks are privately owned. During the review quarter, 100 new bank branches were opened raising the total number of bank branches to 2,208. As a result, the ratio of total bank branches to total population improved to 39,834 from 49,674.8a year ago, reflecting a significant annual improvement in financial service outreach.

About 34.1 percent of the total bank branches were located in Addis Ababa, implying relatively high concentration of branches in the capital. Of the total bank branches, the share of private banks increased marginally to 55 percent from 54 percent in the preceding quarter due to the opening of 70 new branches compared with 30 new branches opened by public banks.

Meanwhile, the total capital of the banking system increased by 3.2 percent over the preceding quarter and reached Birr 26.4 Billion, of which private banks together had a 55.3 percent share. Commercial Bank of Ethiopia, the largest state owned bank, accounted for 34.2 percent of the total capital of the banking system. The remaining balance (10.5 percent) being held by the other two state owned banks, namely, Development Bank of Ethiopia and Construction & Business Bank.

The total number of insurance companies operating in the country remained at 17 of which 16 were private. Yet, the number of branches increased to 332 from 323 of which, about 54.8 percent were situated in Addis Ababa.

During the review quarter, the total capital of the insurance industry scaled up by 9.6 percent on quarterly basis and reached Birr 2.0 billion. The capital share of the private insurance companies stood at 79.0 percent against 78.0 percent in the preceding quarter.

Likewise, there were 31 micro-finance institutions (MFIs) operating in the country. They mobilized a total saving deposit of Birr 11.8 billion, about 15.9 and 54.8 percent higher than the preceding quarter and last year same period, respectively. Similarly, outstanding credit of the MFIs scaled up by 18.8 percent on quarterly and 31.9 percent on annual bases and reached Birr 16.9 billion. As a result, their total assets increased by 8.5 and 38.6 percent on quarterly and annual bases, respectively and stood at Birr 24.5 billion by the end of June 2014. Given their intended purpose, MFIs in the country are contributing to poverty reduction by providing loans to and mobilizing savings from low income segments of the population.

Total resources mobilized by the banking system increased by 9.9 percent over the preceding quarter due to higher net change in borrowing and loans collected offsetting the quarterly fall in net change of deposits. Year-on-year, total resources mobilized by the banking system surged by 21.7 percent owing to an increase in net change in deposits and loan collections by 23.7 and 26percent, respectively.

During the review quarter, total disbursement of new loans by the banking system reached Birr 18.1 billion, indicating a 16.4 percent quarterly and 35.3 percent annual growth. Public banks disbursed Birr 11.6 billion (64.3 percent) and private banks the remaining balance.

The banking system collected Birr 16.7 billion loans granted, about 35.1 percent higher than the preceding quarter and 26percent over last year same quarter. Of the total loans, private banks collected Birr 7.9 billion (47.1 percent) and public banks Birr 8.8 billion (52.9 percent). Of the total loan collection, 88.9 percent was from private sector (including cooperatives).

Total outstanding credit of the banking system (excluding credit to the central government) showed a quarterly increase of 3.3 percent to Birr 168.4 billion at the end of June, 2014.

External Sector and Foreign Exchange Developments

Total merchandise export at USD 967 million increased by 14.8 percent compared to the same period last year but decreased by 0.9 percent vis-a-vis the preceding quarter. The year-on-year increase resulted from the rise in the export earnings from coffee (41.5 percent), oil seeds (17.1 percent), chat (0.5 percent), flower (7.8 percent), live-animals (0.2 percent), meat and meat products (12.6 percent) and fruits & vegetables (8.7 percent). The growth in earnings from these export items was made possible on account of higher volume of exports and/ or prices or both.

On quarterly terms, despite a surge in export earnings from coffee (98.3 percent), gold (7.5 percent) and meat & meat products (24.6 percent), total export earnings slightly went down by 0.9 percent owing to a slowdown in export earnings from oilseeds (53.0

percent), chat (2.7 percent), pulses (24.3 percent), flower (6.9 percent), live-animals (21.6 percent), leather and leather products (4.2 percent) and fruits & vegetables (2.2 percent).

Both year-on-year and quarterly increase in export earnings from coffee was attributed to considerable surge both in value and volume of coffee export. While export volume surged by about 17 and79 percent, the unit price of coffee increased by 10.8 and 20.5 percent over the previous quarter and last year the same quarter, respectively. Consequently, export of coffee fetched USD326.9 million in the fourth quarter of 2013/14 compared to USD 231.1 million a year earlier. Hence, the share of coffee in total export earnings increased to 33.8 percent from 27.4 percent, last year same period.

Total imports during the fourth quarter of 2013/14 stood at USD 3.6 billion, which was 35.7 percent higher than last year as a result of higher import values of capital goods (58.6 percent), consumer goods (2.6 percent), fuel (33.5 percent), semi-finished goods (33.6 percent) and raw materials (66.3 percent). The growth in import value of capital goods was attributed to a rise in imports of industrial goods (70.1 percent), transport goods (21.5 percent) and agricultural goods (158 percent).The increase in import bill of semi-finished goods was mainly attributed to higher import bill of fertilizer (29.5 percent).

On the other hand, despite the quarterly rise in import payment for capital goods (4.6 percent), fuel (3.6 percent) and raw materials (71.0 percent), total import bill went down by 1.8 percent as a result of lower import bill for both durable and non-durable consumer goods (12.8 percent) and semi-finished goods (11.3 percent) particularly fertilizer (51 percent).

During the review period, total net transfers receipt increased by 15.6 percent relative to last year same period, and reached USD 1.3 billion as private transfers increased by 38.0 percent to USD 1.1 billion on account of the 18.6 percent rise in cash remittances from private individuals and higher transfers to NGOs (23.1 percent).Meanwhile, official transfers dropped by 49.6 percent during the same period.

In the review period, capital account recorded USD 2.1 billion in surplus about 168.1 percent higher than last year same period. This was due to the rise in inflows of net official long-term capital (8.4 percent), foreign direct investment (69.8 percent) and other public long-term capital.

The current account balance (including official transfers) registered USD 1.4 billion in deficit during the fourth quarter of 2013/14, which was higher than USD 575.1 million deficit a year ago. The widening deficit is attributed to the lower net services receipts (103.8 percent), net official transfers (49.6 percent) and an increase in trade deficit (45.3 percent).

Average official exchange rate of the Birr in the inter-bank foreign exchange market depreciated by 4.9 percent and 1.4 percent compared to last year same period and the preceding quarter, respectively, and stood at Birr 19.44/USD.

In the same way, the parallel market average exchange rate was Birr 20.34/USD, showing a 0.7 percent depreciation vis-à-vis last year same period and by 2.6 percent against the preceding quarter. As a result, the premium between the parallel and official exchange rates narrowed to 4.7 percent from 9 percent in same quarter last year, but widened against 3.3 percent in the previous quarter.

Meanwhile, due to the concerted efforts of the government to contain inflation in a single digit, REER of the Birr depreciated by 1.5 percent against the preceding quarter although it appreciated by 0.4 percent vis-à-vis the same quarter last year, due to relatively higher domestic price compared to that of major trading partner countries. Similarly, NEER depreciated by 2.2 against the preceding quarter and by 3.3 percent compared to the same quarter last year.

Federal Government Fiscal Operations

Total revenue and grants of the federal government reached Birr 31 billion, during the review quarter, depicting annual surge of 32.2 and a quarterly increase of 11.3 percent.

At the same time, federal government total expenditure was Birr 42.5 billion showing a 1.8percent yearly and 27.5 percent quarterly increase. The quarterly growth of government expenditure was attributed to a 58 percent increase in capital expenditure, 24.1 percent rise in current expenditure and1.9 percent increase in regional transfers.

As a result, the overall fiscal balance (including grants) revealed Birr 11.5 billion deficit compared to Birr 5.4 billion and Birr 14.5 billion deficit registered in the preceding quarter and last year same quarter, respectively.

Investment

A total of 1,201 investment projects with an aggregate capital of Birr 14.1 billion were licensed by the Ethiopian Investment Agency and Regional Investment Offices during the fourth quarter of 2013/14. The number of approved and registered investment projects decreased by 11.6 and 64.4 percent on quarterly basis respectively. Similarly, on annual basis the number of registered projects and capital investment went down by 14.3and 51.8 percent, respectively.

Ownership wise, of the licensed investment projects, about 99.7 percent were private. At the same time,1,117projects (93 percent) were domestic and the remaining 80 projects (6.7 percent) foreign.