

I.OVERVIEW

1.1 International Economic Developments

The European Central Bank's (ECB) economic bulletin issued on July 7, 2015 indicated that global real GDP growth remained moderate in the third quarter of 2015, with substantial difference across major economies. The global composite output Purchasing Managers' Index (PMI) excluding the euro area fell slightly in the third quarter and remained below its long-term average, pointing to continued moderate GDP growth. Developments diverged somewhat across advanced economies, although quarterly composite output PMIs in the United States, United Kingdom and Japan remained close to or above their long-term averages. Meanwhile, PMIs in the emerging market economies (EMEs) continued to weigh on the global index, with notable weakness in the quarterly output PMI in Brazil in the third quarter.

In United State, growth activity appears to have softened in the third quarter of 2015, following a strong rebound in the second quarter. Real GDP was robust in the second quarter, growing by 1.0 percent quarter on quarter (up from 0.2 percent in the previous quarter). Consumption expenditure continued to be the main engine of growth and is expected to remain strong, supported by rising real incomes, reduced debt service burdens, low interest rates and declining gasoline prices. Meanwhile, weakness in the manufacturing sector appears to have intensified recently, as indicated by the decline in the institute of supply management manufacturing index over the past three months. In addition, recent trade data suggest that net exports could act as a drag on activity in the third quarter, against the background of a strong US dollar and relatively weak foreign demand.

In Japan, momentum in the economy remained moderately subdued, following a turn down in economic activity in the second quarter of this year. Real GDP fell in the second quarter (-0.3 percent quarter on quarter), partially because of temporary factors such as adverse weather conditions, but also as a result of substantial weakness in private consumption and foreign demand. Available monthly indicators for the third quarter paint a mixed picture.

Although the increase in the synthetic consumption index in August suggests a rebound in consumer spending, consumer sentiment remains fragile. Meanwhile, private sector core machinery orders a leading indicator for business investment spending fell considerably in July and August.

In China, recent data overall remain consistent with a gradual slowdown of the economy. Real GDP grew by 1.8 percent quarter on quarter in the third quarter of 2015, unchanged from the previous quarter. While some indicators particularly those associated with heavy industries and construction have clearly retreated in recent quarters, the structural changes underway in the economy away from heavy industries and towards services and consumption together with the greater resilience of the other sectors, suggest that, overall, available data remain consistent with an economy undergoing a gradual slowdown. Activity is supported by past monetary and fiscal stimulus working its way through the economy, thus buffering the Chinese economy from sharper slowdown.

1.2. Macroeconomic Developments in Ethiopia

In fiscal year 2014/15 Ethiopia registered GDP growth of 10.2 percent somewhat lower than the targeted 11.2 percent for the fiscal year. The growth has been also remarkable compared to the 4.4 percent growth projected for sub-Saharan Africa in 2015. The growth was also broad based as industry recorded 21.6 percent growth, service grew by 10.2 percent while agriculture surged by 6.4 percent.

Fuel prices

During the first quarter of 2015/16, the average price of Brent crude oil, used as a point of reference for international oil price, declined by 51 percent and reached USD 50 per barrel compared with the USD 102.1 recorded a year earlier. Likewise, the average price of Brent oil showed a 19.4 percent contraction compared with the previous quarter.

In line with the movements in the level of international oil prices and other factors, domestic retail prices have been adjusted accordingly. In the quarter under review, the average retail price of fuel products in Addis Ababa declined by 17.8 percent to 15.6 Birr/liter from 18.97 Birr/liter

in the same quarter of last year. Compared with the preceding quarter, however, the retail prices were up by 1.1 percent.

Inflation

During the first quarter of the fiscal year 2015/16, general inflation scaled down to 3.9 percent from 4.3 percent in the previous quarter, but much higher than 1.9 percent inflation registered last fiscal year same quarter. The 0.4 percentage point marginal slowdown in quarterly headline inflation was attributed to the 1.2 percent decline in non-food inflation offsetting the 0.2 percent rise in food & non-alcoholic beverages. Quarter-on-quarter, however, headline inflation registered a 2.4 percentage point surge on account of 3.4 percentage point increase in food & non-alcoholic beverages inflation and a 0.4 percent rise in non food inflation. Hence, in the reviewed quarter, food & non alcoholic beverage inflation contributed 3.3 percent and non-food inflation 0.6 percent to the headline inflation.

Monetary Developments

Broad money supply (M2) reached Birr 380.7 billion at the close of the first quarter of 2015/16, revealing a 2.5 percent quarterly growth and 25 percent expansion annual basis. The annual increase in broad money supply was mainly due to 28.5 percent rise in domestic credit that offset a 7.3 percent slowdown in net foreign asset. The growth in domestic credit vis-à-vis last year same quarter was owing to a 31.6 percent surge in credit to non-central government while net credit to central government dropped by 5.5 percent.

Reserve money reached Birr 91.9 billion at the end of the first quarter of 2015/16, depicting a 6.4 percent annual growth. It, however, contracted by 10.3 percent on quarterly terms. Meanwhile, excess reserves of commercial banks showed a 47.2 and 37.4 percent slowdown on annual and quarterly basis, respectively.

The money multiplier measured by the ratio of broad money to reserve money, grew by 17.5 percent compared to last year same quarter reflecting the improvement in the monetization of the

economy. Similarly, the ratio of narrow money to reserve money showed 11.1 percent quarter-on-quarter growth.

Interest rate

Average savings deposit and lending rates remained unchanged at 5.4 and 11.9 percent, respectively. Weighted average time deposit rate, however, slightly declined by 1.0 percentage point annual basis. Weighted average yield on T-bills also dropped from 1.68 to 1.25 percent. Hence, considering the September 2015 annual headline inflation of 11.9 percent, all real deposit rates, average lending rate and the T-bill yield were negative.

Financial Sector Developments

Banks, insurance companies and microfinance institutions are the main formal financial institutions operating in Ethiopia. By end September 2015, the number of banks stood at 19, of which 16 were privately owned.

During the review quarter, 94 new bank branches were opened, raising the total number of bank branches to 2,787. As a result, population to total bank branch ratio has reached 33,083. About 35.6 percent of the total bank branches were located in Addis Ababa. Of the total bank branches, the share of private banks increased marginally to 59.1 percent due to the opening of 83 new branches by private banks compared to 11 by public banks during the review quarter.

In the meantime, the total capital of the banking system increased by 16.4 percent compared to the preceding quarter and reached Birr 36.7 billion, of which private banks accounted for 48.4 percent. The share of Commercial Bank of Ethiopia, the giant state owned bank, in the total capital of the banking system declined to 29.2 percent from 37.3 percent a year ago, while that of the Development Bank of Ethiopia and Construction & Business Bank altogether was 22.4 percent.

By end September 2015, there were 17 insurance companies having 377 branches were operating in the country. Of the total insurance companies 16 were private. Of the total branches, about 52.8 percent were located in Addis Ababa.

At the same time, the total capital of the insurance industry increased by 40.8 percent over last year same quarter and reached Birr 2.8 billion. The share of private insurance companies in total capital was 77.6 percent showing a 1.1 percentage point decline compared to the same period last year.

Another financial institutions are micro-finance institutions (MFIs) whose number reached 34 by end September 2015. These MFIs mobilized a total saving deposit of around Birr 15.3 billion, which was 29.3 percent higher than last year the same quarter. Similarly, their outstanding credit increased by 29.8 percent to reach Birr 22.7 billion. As a result, their total asset expanded by 25.3 percent from last year same quarter and reached Birr 31.4 billion .They are serving about 4.5 million clients both in rural and urban areas thereby contributing to poverty reduction by mobilizing savings from and providing loans to the low-income segments of the population.

Total resources mobilized by the banking system (the sum of net change in deposit mobilization, loans collected and net change in borrowings) registered a 22.1 percent surge compared to the same quarter a year ago.

New loans of the banking system reached Birr 19.4 billion during the review quarter reflecting a 21.1 percent year-on-year growth. Public banks disbursed Birr 8.7 billion (44.6 percent) while the remaining balance was handled by private banks. All the new loans of private banks went to finance private sector (including cooperatives) while public banks lent to both private and public enterprises.

Industry was the largest beneficiary sector of the fresh bank loans accounting for Birr 4.4 billion (22.8 percent) followed by domestic trade (Birr 3.9 billion or 20.2 percent), agriculture (Birr 3.8 billion or 19.8 percent) , international trade (Birr 2.8 billion or 14.5 percent), and housing and construction (Birr 1.9 billion or 9.7 percent).

During the review quarter, the banking system collected Birr 18.0 billion, about 18.1 percent higher than last year same quarter. Of the total loans collected, the share of private banks was Birr 10.2 billion (56.8 percent) while the balance, Birr 7.4 billion (43.2 percent) was that of public banks. About 97.3 percent of the loan collected was from private enterprises (including cooperatives).

Total outstanding credit of the banking system (excluding credit to the central government and interbank lending) increased to Birr 222.1 billion at the end of September 2015, showing a 28.9 percent growth. Most of the total outstanding loan and advances are on private sector (including cooperatives).

External Sector and Foreign Exchange Developments

Total merchandise export earnings, including electricity, decreased by 6.6 percent compared to the same quarter last year and amounted to USD 687.2 million. The annual decline was ascribed to lower export earnings from gold (5.6 percent), oilseeds (40.2 percent), pulses (21.9 percent), leather & leather products (10.4 percent) and electricity (63.9 percent) as a result of fusing international price, volume of export or both. The 14.1 percent quarterly slowdown in the total export proceeds on the other hand was on account of the fall in the export earnings of major export items, mainly coffee (38.5 percent), oilseeds (56.1 percent), leather & leather products (13.7 percent), flower (5.9 percent) and electricity (17.1 percent).

In contrast, total import bill increased by 12.6 percent to USD 4.1 billion due to the higher import value of capital goods (33.9 percent), semi-finished goods (35 percent), raw materials (13.1 percent) and consumer goods (0.2 percent) counterbalancing a 35.5 percent decline in fuel import bill.

At the same time, total net transfer receipts registered a 4 percent decline compared to last year same quarter and stood at USD 1.4 billion as net official transfers decreased by 41 percent.

Relative to last year same quarter, net private transfers surged by 5.6 percent and amounted to USD 1.2 billion on account of the 27.3 percent surge in transfers to NGO and 12.1 percent growth in underground transfers from private individuals .

In a nutshell, the current account balance (including official transfers) registered USD 2.1 billion in deficit during the first quarter of 2015/16, higher than USD 1.4 billion deficit a year earlier, as net services receipts and net official transfers dropped and trade deficit widened.

In the review quarter, the capital account recorded USD 706.4 million in surplus; about 46.8 percent lower than that of last year same quarter. This was due to slowdown in inflows of net other public sector long-term capital and short term capital vis-a-vis a surge in other official long-term capital and foreign direct investment.

As for inter-bank forex market, the weighted average official exchange rate of Birr against USD depreciated by 4.9 percent compared to last year same quarter and reached Birr 20.6965/USD. Likewise, the average exchange rate in the parallel market depreciated by 9.5 percent and stood at Birr 23.0738/USD. As a result, the parallel market premium widened to 11.5 percent from 6.8 percent a year earlier largely due to speculative practices.

The real effective exchange rate of the Birr (REER) appreciated both on annual and quarterly terms by 14.3 percent and 3 percent, respectively. This was largely on account of relatively higher domestic inflation and fast depreciation of trading partners' nominal exchange rate compared to that of the Ethiopian Birr. Similarly, NEER appreciated by 0.14 percent and 4.5 percent vis-à-vis the preceding quarter and last year same quarter, respectively.

Federal Government Fiscal Operations

The Federal government collected tax and non-tax revenue amounted to Birr 38.7 billion during the first quarter of 2015/16, about 24.7 percent higher than last year same quarter. Tax revenue accounted for 88.0 percent and non-tax revenues 12 percent of total revenue.

Similarly, total Federal government expenditures, including regional transfers, registered a 22.7 percent annual growth to reach Birr 40.1 billion. Regional transfers accounted for Birr 16.4 billion or (40.5 percent) followed by capital expenditure (Birr 14.5 billion or 36.1 percent) and current expenditure (Birr 9.3 billion or 23.41 percent).

As a result, the Federal government budgetary operations witnessed Birr 1.4 billion overall deficit (including grants) which has, significantly narrowed from a deficit of Birr 20.5 billion last year same quarter.

Investment

During the first quarter of 2015/16, 674 investment projects with total investment capital of Birr 3.8 billion become operational. Year on year basis, the number of investment projects and the amount of investment capital grew by remarkable amount.