VIII. International Economic Developments

8.1 Overview of the World Economy[4]

The recent decline in oil prices is supporting the global economic recovery. In response to a well-supplied oil market, Brent crude oil prices continued to decline sharply in December. According to the futures curve, markets have priced in only a gradual increase in oil prices for the coming years. As lower oil prices lead to a redistribution of income from net oil producers to net oil consumers, this supports global demand, as net oil-consuming countries tend to have a higher propensity to spend. Despite the support from lower oil prices, the global economic recovery remains gradual, and surveys point to some softening in the growth momentum in the fourth quarter of 2014.

Global trade continues to show signs of strengthening. The volume of world merchandise imports excluding the euro area increased by 3.4 percent on a three-month-on-three-month basis in October, moving further above its long-term average. However, the global PMI for new manufacturing export orders moderated in the final quarter of 2014.

In the United States, economic activity was stronger than expected, and indicators point to robust growth in the short term. According to the third estimate, real GDP growth increased by 1.2 percent quarter on quarter in the third quarter of 2014, which is the strongest growth rate in almost a decade. Recent data remained robust, suggesting only a slight moderation in growth in the final quarter of the year. On balance, the income windfall for consumers from lower oil prices is expected to more than offset the negative impact from the further strengthening of the US dollar since December, thus providing a boost to the overall outlook for the United States.

In Japan, the economy failed to re-gain sustained traction after the hike in VAT in April, the government announced further fiscal stimulus measures. The second data release confirmed the decline in Japanese real GDP by 0.5 percent quarter on quarter

[4] Sections 8.1 – 8.4 are excerpted from European Central Bank monthly bulletin of September, October and November 2014.

in the third quarter of 2014. High-frequency indicators point to a return to positive, albeit weak, growth in the fourth quarter. At the end of 2014 the government announced a stimulus package and a reduction in the effective corporate tax rate in order to support growth.

In the United Kingdom, short-term indicators point to a slowdown in economic activity, while inflation has fallen to very low levels. While activity will be supported by higher real disposable income in view of falling energy prices, survey indicators point towards a near-term slowdown in the pace of expansion.

In Sweden, real GDP increased by 0.3 percent quarter on quarter in the third quarter of 2014, following 0.5 percent in the previous quarter. In Denmark, economic activity accelerated from 0.1 percent quarter on quarter in the second quarter of 2014 to 0.5 percent in the third quarter. In both countries, economic activity was mainly supported by domestic demand. Looking ahead real GDP growth is likely to gain strength in both countries.

In the largest central and eastern European (CEE) EU Member States, economic activity continued to expand at a varying pace in the third quarter of 2014, following robust growth overall in the first half of the year. Growth in the third quarter was particularly strong in Romania, where real GDP expanded at a quarterly rate of 1.9 percent, after contracting by 0.3 percent in the second quarter. Economic activity also remained vigorous in Poland, where the quarterly rate of change in real GDP accelerated to 0.9 percent in the third quarter from 0.7 percent in the second quarter. Czech real GDP growth also accelerated to a quarterly rate of 0.4 percent in the third quarter, after 0.2 percent in the second. In Hungary, meanwhile, real GDP growth continued to decelerate, slowing to 0.5 percent in the third quarter after standing at 0.8 percent in the previous quarter.

In Turkey, following a robust increase over the past year economic activity contracted by 0.5 percent in quarterly terms in the second quarter of 2014, driven by broad-based weakness across components.

In Russia, with the fall in oil prices accelerating in December, tensions in Russian financial and foreign exchange markets intensified, triggering forceful policy action. Following a rise of 100 basis points at its regular meeting on 11 December 2014, the Central Bank of Russia increased the policy rate by a further 650 basis points to 17% on 15 December 2014.

In China, growth momentum has slowed, and inflation remains low. Quarterly GDP growth slowed to 1.5 percent in the final quarter of 2014 on the back of weakness in the housing market and heavy industries. In a longer term perspective, Chinese growth continues on its path of gradual deceleration, although the recent drop in oil prices could provide some temporary support.

Turning to other emerging Asian economies, the economic recovery remains gradual; following a period of subdued growth, as the slowdown of the Chinese economy over recent months particularly affected many export-oriented countries in the region.

Going into more detail, in India, confidence since the election of the new government remains high and stock markets continue to surge. The favorable economic sentiment is in line with the growth in GDP of 6%year on year (at market prices) in the third quarter of 2014. As a big net commodity importer, India benefits from falling commodity prices, while its service-driven exports are less affected by the current weakness in global demand for manufactured goods.

In Indonesia, the improvement in economic sentiment related to the election of the new president has not yet translated into improved economic performance, and GDP growth remained weak in the third quarter of 2014 at 1.2 percent quarter on quarter, mainly owing to sluggish external demand conditions.

In Korea, GDP growth improved slightly in the third quarter of 2014 (0.9 percent quarter on quarter), as consumption benefited from monetary and fiscal stimulus measures. However, subdued demand from China along with a weak Japanese yen has had an impact on Korea’s exports, which contracted in the third quarter, creating uncertainty with respect to Korea's export-driven recovery.

The slowdown in growth in Latin America continued into the second half of the year, while the divergent trends in the region have become more pronounced.

Brazil faces an environment of low growth and high inflation. After two quarters of negative growth, real GDP expanded only by 0.1 percent quarter on quarter in the third quarter of 2014, supported by government consumption and investment, whereas private consumption continued to worsen. The substantial tightening of the monetary policy stance, softer external demand, weak confidence and policy uncertainties have weighed on growth.

Argentina is currently in a recessionary phase. According to the monthly economic activity indicator, real output declined by -0.2 percent year on year in September 2014. Elevated domestic imbalances, high inflation and a weak fiscal position are hampering growth. Lower demand from Brazil, one of the Argentina's key trading partners, and increased uncertainty after it technically defaulted on its foreign bonds at the end of October have both placed an additional burden on the economy.

By contrast, in Mexico, activity is recovering from a sharp slowdown in 2013, while benefitting from strengthened US demand, expansionary fiscal policy and low interest rates. Real GDP growth stood at 0.5 percent quarter on quarter in the third quarter, down from 1 percent in the previous quarter. The loss of momentum was mostly associated with weaknesses in both the industry and services sectors, whereas agricultural output improved. Nonetheless, the government is intensifying its efforts to implement the substantial package of structural reforms introduced since 2013 that are aimed at boosting growth in the years ahead.

8.2. Inflation Developments

Falling energy prices are leading to a decline in global inflation. As a result, annual consumer price inflation in the OECD area decreased further to 1.5 percent in November. The fall in inflation was broad-based across major economies, except for Russia, which experienced a significant increase. Annual OECD inflation excluding food and energy fell further to 1.7 percent in November. Given the ongoing weakness in commodity prices, it is expected that significant downward pressures on global inflation will continue.

In United States, inflation has moderated from its recent peak in May and has stabilized over the past three months. Annual headline CPI inflation stood at 1.7 percent in October, a decline of 0.5 percentage point since May. This reflects predominantly the unwinding of temporary factors, including a sharp decline in energy costs (from 3.4 percent year on year in May to -1.6 percent year on year in October), as well as a stabilization in services price inflation. By contrast, inflation in the price of food and shelter increased slightly over the past five months. Annual CPI inflation excluding food and energy was broadly stable in recent months, standing at 1.8 percent in October.

In Japan, CPI inflation has been on a downward trend since May 2014, reaching 2.9 percent year on year in October, as the impact from the previous depreciation of the yen dissipated and energy prices continued to fall. While the fall in energy prices should boost disposable income in the medium term, in the short run it may dampen the upward trend in prices and inflation expectations that Japan has experienced since the launch of Abenomics. Finally, the CPI excluding the direct effects of the consumption tax hike is now estimated to be at around 1 percent according to the Bank of Japan's latest figures.

In United Kingdom, inflation has remained below the Bank of England's target of 2 percent in the course of 2014. Annual CPI inflation marginally increased to 1.3 percent in October, mainly on account of positive base effects from transport prices. Consumer price inflation excluding food and energy stayed at around 1.5 percent in October. Overall, inflationary pressures are expected to remain subdued, and the inflation rate is expected to decline further in the near term, reflecting falls in energy and import prices.

In CEE economies, annual HICP inflation in the CEE region generally remains subdued. Although over recent months it accelerated somewhat in the Czech Republic and Romania, it stands close to historical lows – at around zero – in Poland and Hungary. These developments are a reflection of falling food and energy prices mirroring mostly global developments and of relatively subdued domestic cost pressures.

In Russia, consumer price inflation has continued to climb and reached 8.3 percent year on year in October, which is considerably above the central bank's target of 4 percent (with a tolerance interval of ±1.5 percentage points). These developments mainly reflected the rouble's sharp depreciation and rising food prices, triggering the central bank to further tighten its monetary policy stance through a series of increases in its main interest rate during the year, up to 9.5 percent in November in 2014 (+400 basis points since the start of the year).

In China, economy-wide price pressures are on a downward path and hovering near two-and-a-half-year lows, reflecting tepid demand and overcapacity in heavy industry. In particular, PPI inflation has been in negative territory for 32 months, which is the longest period since 1997. In line with low inflation, the People's Bank of China lowered its benchmark lending and deposit rates on 21 November 2014for the first time since July 2012.

In India, inflation has also been coming down sharply over the course of the year as a result of falling food and energy prices, and tight fiscal and monetary policy.

In Indonesia, after a sharp decrease in the first eight months of the year, inflation accelerated against the backdrop of the recent cut in fuel subsidies by the new government. In response to the rise in fuel prices, Indonesia's central bank decided to increase its policy rate by 25 basis points to7.75 percent In Korea, as consumer price inflation remains low, the Bank of Korea decided to further cut interest rates by 25 basis points in October.

In Brazil, inflationary pressures have intensified in recent months, exceeding the 6.5% upper-bound of the inflation target, driven to a significant extent by the depreciation of the exchange rate. Together with high inflation expectations, this prompted the central bank to further increase the monetary policy interest rate to11.25 percent in October (+25 basis points).

8.3. Commodity price

The global inflation outlook is influenced strongly by developments in commodity prices, in particular oil prices. Since early July 2014 oil prices have been on a downward path, reaching levels of around USD 84 per barrel on average in the current quarter. Brent crude oil prices stood at USD 71 per barrel on3 December, which was about 35 percent lower than their level a year earlier. This decline in oil prices reflects levels of oil supply that have exceeded oil demand. Despite the conflicts in Libya and Iraq, OPEC produced above the group's official target, while non-OPEC oil production increased on the back of US shale oil exploitation. At the same time oil demand continued to be weak partly owing to a slowdown in the Chinese industrial sector.

Non-energy commodity price developments have been on a slightly upward trend since the beginning of the fourth quarter, following a decline in September. Since early October non-energy prices have inched up by 2 percent reflecting an 8 percent rise in grain prices and a 2 percent rise in metal prices. Unusually cold weather in the United States, as well as the ongoing conflict between two major grain suppliers, Ukraine and Russia, which is affecting both planting and trading activities, have pushed up grain prices recently. Compared with a year ago, the non-energy commodity price index in aggregate terms (denominated in USD) is currently about 8 percent lower, mainly owing to reduced grain prices driven by a record US harvest.

8.4. Exchange Rate Developments

From early September to 3 December 2014 the euro depreciated against the currencies of most of the euro area's main trading partners. Movements in exchange rates were largely related to developments in expectations about future monetary policy, as well as to adjustments in market expectations regarding the economic outlook for the euro area relative to other major economies. On 3 December 2014 the nominal effective exchange rate of the euro, as measured against the currencies of 20 of the euro area's most important trading partners, stood at 1.8 percent below its level at the beginning of September and 3.9 percent below its level one year earlier.

In bilateral terms, since early September the euro has weakened against the US dollar (by 6.1 percent) and, to a much lesser extent, against the pound sterling. By contrast, it appreciated considerably against the Japanese yen (by 7.5 percent) following the announcement of the expansion of the Quantitative and Qualitative Monetary Easing program by the Bank of Japan at the end of October. During that period the euro also appreciated against most currencies of commodity-exporting countries and a number of currencies of emerging market economies in Asia, with the notable exception of the Chinese renminbi, against which it weakened by 6.1%. Meanwhile, since early September, the euro strengthened by 33.5 percent vis-à-vis the Russian rouble.

8.5. Impact of Global Economic Development on Ethiopian Economy

During the period under review, the gradual recovery of the global economy to some extent affected the external sector of Ethiopia. The net capital inflow increased by 200.3 percent vis-à-vis last year same period. This was due to the rise in inflows of net official long-term capital (278.4 percent), other public long-term capital and foreign direct investment (44.8 percent).

However, despite the gradual recovery of the global economy, export fell by 6.2

percent due to increased value and volume of major export commodities; net services receipts fell by 109.9 percent due to declines in net travel services, net transport services and government services; net private transfers fell by 5.5 percent and net official transfers fell by 85.7 percent.

On the other hand, imports have risen by 25.3 percent vis-à-vis last year same period mainly driven by larger values of capital goods, consumer goods and semi-finished goods.

Consequently, the significant rise in current account deficits resulted in USD 5.2 million balance of payments deficits.