I.OVERVIEW

1.1 International Economic Developments

The recent turndown in oil prices is supporting the global economic improvement. In response to a well-supplied oil market, Brent crude oil prices continued to slowdown stridently in December 2014. 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.

In the United States, economic activity was stronger than expected, and indicators point to vigorous growth in the short term. According to the third estimate, real GDP growth picked up by 1.2 percent quarter-on-quarters in the third quarter of 2014, which is the strongest growth rate in almost a decade. Recent data remained robust, suggesting only a slender 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 grip 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 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 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.

During the period under review, the gradual recovery of the global economy to some extent has positively 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).

In contrast, export fell by 6.2 percent due to slowdown in value and volume of major export commodities; net services receipts dropped by 109.9 percent due to declines in net travel services, net transport services and government services. Net private transfers also went down by 5.5 percent, and net official transfers 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 higher imports of capital goods, consumer goods and semi-finished goods. Consequently, current account deficit (including official transfers) widened to USD 2.7 billion during the review quarter.

1.2. Macroeconomic Developments in Ethiopia

Fuel prices

During the second quarter of 2014/15, the average price of Brent crude oil, used as a point of reference for international oil price, declined by 30.6 percent and stood at USD 76 per barrel compared with USD 109.4 recorded in the previous year same quarter. Similarly, the average price showed a 25.6 percent reduction as compared with the previous quarter.

In the review quarter, the average retail price of fuel products in Addis Ababa went up marginally by 2.2 percent to 18 Birr/liter from 17.62 Birr/liter in the same quarter of last year despite a reduction of oil price in the international market. However, the retail prices were down by 5.1 percent compared with 18.97 Birr/liter registered in the preceding quarter.

Inflation

During the second quarter of the fiscal year 2014/15, quarterly headline inflation slowed to 1.0 percent on account of a 2.6 percentage point decline in food & non-alcoholic beverages which offset a surge in non-food inflation by 1.0 percentage point. Similarly, quarter-on-quarter headline inflation decelerated by about 0.3 percentage point. Food & non-alcoholic beverages inflation declined to 0.1 percent from 0.3 percent in same quarter of last fiscal year. Non-food inflation dropped to 1.9 percent compared to the previous year same quarter contributing a 0.9 percent share to the quarterly headline inflation while food & non-alcoholic beverages contributed the remaining 0.1 percent.

Monetary Developments

Broad money supply (M_2) reached Birr 325.8 billion at the end of the second quarter of 2014/15, revealing a 7.0 percent quarterly expansion and 29.1 percent surge on annual basis. The yearly expansion in broad money was driven by 30.0 and 17.5 percent growth in domestic credit and net foreign asset, respectively. The growth in domestic credit vis-à-vis last year same quarter was due to 30.0 percent increase in credit to non-central government and a 28.8 percent in central government.

Reserve money registered quarterly and quarter-on-quarter increment of 5.1 and 25.5 percent to reach Birr 90.7 billion at the end of the review quarter. Meanwhile, excess reserve of commercial banks decreased by 4.9 and 38.3 percent compared to last year same quarter and the previous quarter, respectively.

The money multiplier measured by the ratio of broad money to reserve money, grew by 2.9 percent quarter-on-quarter basis implying an improvement in monetization of the economy. On the other hand, the ratio of narrow money to reserve money showed 1.7 percent decline over the same quarter last fiscal year. Owing to expansion of banking services that resulted in increased mobilization of quasi-money deposits.

Interest rate

Average savings deposit and lending rates remained unchanged at 5.4 and 11.88 percent, respectively, throughout the quarters. Weighted average time deposit rate, however, slightly rose by 0.7 percentage points quarter-on-quarter basis. On the other hand, weighted average yield on T-bills decreased to 1.5 percent during the second quarter from 2.28 percent a year ago.

Considering the second quarter headline inflation of 7.1 percent in December 2014, all deposit rates and the t-bills yield remained negative while average lending rate was positive in real terms.

Financial Sector Developments

Banks, insurance companies and microfinance institutions are the common formal financial institutions operating in the Ethiopian economy. The number of banks existing in the country was 19 of which 16 banks were privately owned, unchanged from the previous quarter.

During the review quarter, 487 new bank branches were opened increasing the total number of bank branches to 2,502. As a result, the ratio of total bank branch to total population improved to 1:35,956.83 from 1: 42,977.7 last year same period, reflecting a significant yearly improvement in financial service outreach.

About 34.9 percent of the total bank branches were located in Addis Ababa, implying relatively a high concentration of branches in the capital. Of the total bank branches, the share of the private banks increased marginally to 57 percent from 56 percent in the preceding quarter due to the opening of 361 new branches by private banks surpassing 126 new branches opened by public banks during the review quarter.

Meanwhile, the total capital of the banking system increased by 5.2 percent compared to the preceding quarter and reached Birr 30.2 Billion, of which private banks together took 54.6 percent share. Commercial Bank of Ethiopia, the giant state owned bank, alone accounted for 35.4 percent of the total capital of the banking system. The remaining balance (9.9 percent) owned by other state owned banks, namely Development Bank of Ethiopia and Construction & Business Bank.

The total number of insurance companies operating in the country also remained 17 during the review quarter, of which 16 were privately owned. Their branches also increased to 359 from 337 in the preceding quarter. Of the total branches, about 53.2 percent were located in Addis Ababa. Similarly, their total capital rose by 31.9 percent on quarter-on-quarter basis and reached Birr 2.3 billion with the share of private insurance companies increasing by 2.3 percentage point to 79.7 percent.

On the other hand, there were 32 micro-finance institutions (MFIs) operating in the country. These institutions mobilized a total saving deposit of about Birr 13.0 billion, which was 9.9 percent and 50.1 percent higher than the amount mobilized during the preceding quarter and last year same quarter, respectively. Their outstanding credit also scaled up by 3.1 percent and 31.3 percent on quarterly and quarter-on-quarter basis, respectively, to reach Birr 18.0 billion. As a result, their total assets increased by 6.6 percent and 31.1 percent vis-à-vis the previous quarter and same quarter last fiscal year, respectively and stood at Birr 26.7 billion by the end of December 2014. Given their intended purpose, MFIs in the country are contributing to poverty reduction by providing loans to and mobilizing savings from the low-income segments of the population.

Total resources mobilized by the banking system surged by 64.0 percent against the preceding quarter due to an increase in deposit (net change). Similarly quarter-on-quarter basis, total resources mobilized by the banking system increased by 26.4 percent due to an increase in borrowing (net change), deposit (net change) and loan collections by 152.2, 27.0 and 23.8 percent, respectively.

During the review quarter, total disbursement of new loans by the banking system reached Birr 17.8 billion, indicating a 12.2 percent and 6.4 percent quarterly and quarter-on-quarter surge, respectively. Public banks disbursed Birr 7.4 billion (41.4 percent) while the remaining balance was disbursed by private banks.
About 97.8 percent of new loan disbursement by the private banks and 61.9 percent of the loan disbursed by public banks went to the private sectors.

The banking system collected Birr 12.9 billion, down by 15.2 percent against the preceding quarter but up by 23.8 percent over last year same quarter. Of the total loans collected during the quarter, the share of private banks was Birr 7.6 billion (58.9 percent) and that of public banks Birr 5.3 billion (41.1 percent). Private enterprises repaid 79.8 percent of the banking sector claims followed by public enterprises (11.6 percent) and cooperatives (8.5 percent).

Total outstanding credit of the banking system (excluding credit to government and interbank lending) increased to Birr 192.0 billion at the end of December 2014, up by 11.5 percent on quarterly basis. More than 98.0 percent of the outstanding loan of private banks was a claim on private enterprises and the remaining balance on cooperatives (1.4 percent) and Public enterprises (0.1 percent). On the other hand, 49.3 percent, 43.2 percent and 7.5 percent of the total public banks outstanding loan (excluding credit to government and interbank lending) was a claim on public enterprises, private enterprises, and cooperatives, respectively.

External Sector and Foreign Exchange Developments

Total merchandise export declined by 6.2 and 11.3 percent vis-à-vis the same quarter last year and the preceding quarter, respectively and amounted to USD 639.2 million. The quarter-on-quarter slowdown in export was attributed to lower export earnings from oilseeds (10.0 percent), chat (1.3 percent), gold (45.3 percent), pulses (2.9 percent), leather & leather products (14.3 percent), live-animals (30.6 percent) and fruits & vegetables (4.5 percent). This fall in export earnings was on account of a slowdown in international price, volume or both.

The quarterly decline in the total export proceeds was due to slowdown in export earnings of major export items, mainly coffee (31.0 percent), gold (18.1 percent), pulses (7.3 percent), leather & leather products (8.8 percent), live-animals (51.8 percent) and meat & meat products (12.2 percent).

Export earnings from coffee increased by 47.8 percent on quarter-on-quarter but declined by 31 percent on quarterly basis. The quarter-on-quarter surge in export earnings from coffee resulted from a significant coffee price recovery and an increase in volume of export. In the review period, coffee unit price increased by 23.7 percent vis-à-vis last year same quarter although it declined by 4.4 percent compared to the previous quarter. On the other hand, despite a 19.5 percent increase in volume of coffee export over last year same quarter, it went down by 27.8 percent compared to the previous quarter. Consequently, export earnings from coffee in the second quarter of 2014/15 decreased to USD 126.0 million from USD 182.6 million in the preceding quarter but increased from USD 85.3 million a year ago. The share of coffee in total export earnings increased to 19.7 percent from 12.5 percent last year same quarter but lower than 25.3 percent in the preceding quarter.

Total value of merchandise import during the second quarter of 2014/15 stood at USD 4.4 billion. With respect to last year same quarter, total import bill increased by 25.3 percent owing to higher import value of capital goods (52.2 percent), consumer goods (1.9 percent), semi-finished goods (25.3 percent), fuel (9.0 percent) and raw materials (33.9 percent). On quarterly basis, the total import bill went up by 18.4 percent owing to a surge in import bill of capital goods (by 25.9 percent), consumer goods (2.1 percent), semi-finished goods (37.0 percent), fuel (6.1 percent) and raw material (25.6 percent).

In the review quarter, total net transfer receipts increased by 15.6 percent relative to last year same quarter and stood at USD 1.3 billion as private transfers increased by 38.0 percent on account of a 18.6 percent rise in cash remittances from private individuals and higher transfers to NGO (23.1 percent).

In the review period, the capital account recorded USD 2.88 billion in surplus; about 200.3 percent higher than last year same quarter. 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).

The current account balance (including official transfers) registered USD 2.67 billion in deficit during the second quarter of 2014/15, much wider than USD 578.8 million deficit recorded a year ago. This worsening deficit in current account balance was attributed to the decline in net services receipts (109.9 percent), net private transfers (5.5 percent), net official transfers (85.7 percent) and an increase in trade deficit (33 percent).

The average official exchange rate of the Birr in inter-bank foreign exchange market has depreciated by 5.6 percent and 1.3 percent compared to last year same quarter and the preceding quarter, respectively and reached Birr 19.9925/USD. Likewise, the parallel market average exchange rate depreciated by 14.3 and 5.9 percent during the same period and stood at Birr 22.3220/ USD.

As parallel market showed a relatively faster quarter-on-quarter and quarterly deprecation than official market, the premium between both markets widened to 11.7 percent from 3.2 percent in same quarter last year and 6.8 percent in the previous quarter.

During the second quarter of FY 2014/15, REER of the Birr appreciated both quarterly (1.87 percent) and quarter-on-quarter (2.17 percent) as a result of relatively fast nominal exchange rate deprecation and deflationary trend in major trading partner countries.

Similarly, NEER appreciated by 1.55 percent against the preceding quarter while it depreciated by 1.13 percent in contrast to last year same quarter.

Federal Government Fiscal Operations

During the second quarter of the FY 2014/15, total revenue and grants of the federal government was Birr 40.5 billion showing 23.4 and 20.7 percent growth over last year same quarter and the preceding quarter, respectively. It registered 31.9 percent performance against the annual plan.

On the other hand, the Federal Government total expenditure during the review quarter increased by 35.9 and 41.3 percent vis-à-vis last year same quarter and the previous quarter, respectively to reach Birr 46.2 billion. The growth in government expenditure on quarterly basis was attributed to higher capital expenditure (44.4 per cent), current expenditure (15.7 percent) and regional transfers (39.4 percent).

As a result, the overall fiscal balance (including grants) revealed Birr 5.7 billion deficit, which was higher than Birr 1.2 billion deficit exhibited in the same quarter of last fiscal year.

Investment

A total of 1,359 investment projects with an aggregate capital of Birr 39.8 billion were licensed by the Ethiopian Investment Agency and Regional Investment Offices during the fourth quarter of 2013/14. The number of approved investment projects has increased by 21.9 percent on quarterly basis, despite the decline in the registered investment capital by 20.8 percent. However, on annual basis the number of registered projects and capital investment rose by 110 and 52.6 percent, respectively.

Ownership wise, about 99.7 percent of the approved projects were private of which 1,277 projects (94.2 percent) were domestic while the remaining 78 projects (5.8 percent) were foreign.