VIII. International Economic Developments

8.1 Overview of the World Economy[5]

According to the European Central Bank report for March 2015, global economic activity indicators continue to suggest a steady growth momentum in early 2015. In particular, activity remains solid in both the United States, despite signs of temporary weakness at the start of the year, and the United Kingdom. At the same time, the recovery remains tepid in Japan. Weakening growth in China has led to the implementation of stimulus measures. Decreasing import volumes in emerging markets constitute renewed signs of a softening in global trade. Low energy prices have lowered global headline inflation rates.

In the Euro area the latest economic indicators and survey results are consistent with continued economic expansion in the first quarter of 2015. Looking beyond the short term, the monetary policy measures taken recently by the Governing Council, the low oil price and the depreciation of the euro should help broaden and gradually strengthen the recovery. At the same time, although labor markets have shown some further signs of improvement, unemployment remains high and economic slack is expected to diminish only gradually.

Global trade has shown signs of softening again recently. The volume of world merchandise imports increased by only 0.2% in January a three-month-on-three-month basis, down from 1.4% in December. This decline in momentum was driven by falling import volumes in emerging markets, in particular in China, which might be partly related to the timing of the Chinese New Year. However, the pace of growth in imports among advanced economies continued to increase overall, and the global Purchasing Market Index (PMI) for new export orders remained stable in the first quarter of 2015, suggesting a steady momentum in world trade growth.

In United States, real GDP grew by 0.5% quarter on quarter in the fourth quarter of 2014, down from 1.2% in the previous quarter, largely reflecting a negative contribution from net trade. Recent indicators suggest a slight but transitory slowdown in the first quarter of 2015, mainly owing to cold weather and port disruptions. However, consumption remains

[5]Sections 8.1 – 8.4 are excerpted from European Central Bank monthly bulletin of March, 2015.

sound, supported by lower oil prices, strengthened household balance sheets and improved consumer confidence. The underlying labor market momentum also remains robust, notwithstanding a slowdown in job creation in March.

In Japan, after the return to positive growth at the end of 2014, the pace of growth in the Japanese economy was muted at the start of 2015. Both industrial production and real exports of goods improved up to February, but real imports of goods have also picked up significantly. Available monthly indicators for private consumption have remained weak overall, while the Bank of Japan's Tankan survey for March 2015 only signaled an improvement in business confidence among non-manufacturing firms compared with December 2014.

In United Kingdom, real GDP increased by 0.6% quarter on quarter in the last quarter of 2014, driven mainly by net exports, and domestic demand is expected to sustain growth in the course of 2015. Although private and public sector balance sheet adjustments are still expected to weigh on growth, it is likely that the marked decline in energy prices will support real disposable income and economic activity. The unemployment rate stabilized at 5.7% in the three months to January 2015.

In China, a wide range of indicators, including industrial production, retail sales and manufacturing Purchasing Market Index (PMI), point towards a slowdown in GDP growth at the start of 2015. At the same time housing activity remained weak, and property prices continued to decline. Against this backdrop, China introduced measures to stimulate the housing market by increasing the ceilings on mortgage loan-to-value ratios and reducing the minimum ownership period for tax benefits. These measures are an attempt to halt the slowdown in economic activity by boosting household demand for housing and increasing consumption.

In Russia, the economy remains depressed, with offsetting forces shaping the outlook. Economic activity is expected to contract significantly in 2015 on the back of the fall in oil prices, economic sanctions and the recent turmoil in financial markets. The revised budget passed by the Parliament in April foresees cuts in government expenditure in 2015, which along with a significant fall in revenues, would result in a budget deficit of 3.7% of GDP in 2015. The Central Bank of Russia continued to ease its monetary stance in March, lowering the policy rate by further 100 basis points to 14%. Money market liquidity conditions have started to normalize, although financing costs for the banking system remain elevated. The recent appreciation of the rouble will help to ease inflationary pressures, but might negatively affect exports proceeds and reduce budget revenues.

8.2 Inflation Developments

Low energy prices are weighing on global headline inflation rates. Annual inflation in OECD countries remained low in February at 0.6%, as the annual rate of growth in energy prices remained negative. Excluding food and energy, annual inflation in OECD countries declined only marginally to 1.7%. By contrast, consumer price inflation among major non-OECD countries rose in February and March; picking up slightly in China on the back of rising food prices and increasing further in Brazil and Russia owing to administered price increases and the impact of the depreciation of the rouble and the food embargo respectively.

Inflation in the euro area has remained negative in recent months, but is on an upward trajectory. According to Eurostat's flash estimate, euro area HICP inflation increased to -0.1% in March 2015, from -0.3% in February and -0.6% in January. This upturn reflects the much less negative annual growth rate of energy prices owing to the increase in oil prices in euro terms seen since mid-January. In contrast to headline inflation, the HICP excluding food and energy (which recorded an annual rate of change of 0.6% in March) continues to hover within the range of 0.6% to 1.0% recorded since late 2013.

In the United state reflecting low oil prices and the appreciation of the US dollar, annual headline CPI was flat in February, after having fallen slightly into negative territory in January owing to lower energy and import prices. Excluding food and energy, inflation picked up slightly, driven mainly by higher prices for services.

In Japan after a brief pause at the turn of the year, the annual headline inflation rate slowed in February to 2.2%, largely on account of falling energy prices. Excluding the estimated direct impact of the VAT hike in April 2014, annual headline inflation stood at 0.1%, and core inflation (excluding food and energy) stood at 0.3% in February.

Annual CPI inflation in United Kingdom declined to 0% in February 2015 owing to the fall in energy prices. This was the lowest level of headline inflation since the introduction of the CPI index in 1989. CPI inflation excluding unprocessed food and energy fell marginally to 1.1%.

According to the National Bureau of Statistics of China inflation was recorded at 1.5 percent in April of 2015.

8.3 Commodity price

HICP inflation excluding energy and food has continued on a broadly stable path during the month of February, 2015. Lower oil and other commodity prices have also exerted downward pressure on HICP inflation excluding energy and food as lower input costs have been passed through the price chain.

The direct effects of the decline in oil prices have dominated recent inflation developments. The recent decline in oil prices is likely to have largely been passed through to pre-tax prices for liquid fuels. Other typical direct effects, for example via electricity and gas prices, have also contributed to the recent negative inflation outcomes.

Food prices have also continued to come under downward pressure. In recent months annual inflation rates for unprocessed food prices have edged further into negative territory, while processed food price inflation has moderated further. These developments partly reflect the indirect effects of the declines in agricultural and other commodity prices through the production and price chain.

8.4 Exchange Rate Developments

The effective exchange rate of the euro weakened further over the past few months. The weakening of the euro, which had begun back in May 2014, continued notably in the run-up to the Governing Council's January 2015 meeting, reflecting market expectations of impending monetary policy decisions. Overall, in early March the effective exchange rate of the euro stood around 10% below the level recorded one year earlier. Regarding bilateral exchange rate developments, the euro declined by around 10% against the US dollar between December 2014 and early March 2015. The euro also fell considerably against the Swiss franc following the Swiss National Bank's is continuation of its minimum exchange rate target of 1.20 Swiss francs per euro in mid-January. The Danish krone continued to trade close to its central rate within ERM II during this period, while Danmarks National bank intervened in foreign exchange markets, and reduced the interest rate on certificates of deposit five times. Moreover, on 30 January the issuance of Danish government bonds was suspended until further notice. At the same time, the euro appreciated significantly against 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 97.1 percent vis-à-vis last year same period. This was due to the rise in inflows of net official long-term capital (36.6 percent), other public long-term capital and foreign direct investment (48 percent).

However, despite the gradual recovery of the global economy, export fell by 16.6 percent due to decreased price and volume of major export commodities; net services payments stood at USD 103.8 million due to declines in net travel services, net transport services and rise to other service payments; and net official transfers fell by 40.6 percent.

On the other hand, imports have risen by 13.9 percent vis-à-vis last year same period mainly driven by larger values of capital goods and consumer goods.

Consequently, the significant rise in current account deficits resulted in USD 213.4 million balance of payments deficits.