I. OVERVIEW

1.1 International Economic Developments

According to the European Central Bank report for March 2015, global economic activity indicators have continued to suggest a stable 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 indifferent 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 growth 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 slowly strengthen the revival. At the same time, although labor markets have shown some further signs of improvement, unemployment remains high and economic limp is expected to diminish only gradually.

Global trade has shown signs of softening again recently. The volume of world merchandise imports scaled up by merely 0.2 percent in January on a three-month-on-three-month basis, down from 1.4 percent in December. This slowdown in momentum was driven by falling import volumes in emerging markets, in particular in China, which might be partially related to the timing of the Chinese New Year. However, the pace of growth in imports among advanced economies continued to surge 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 percent quarter-on-quarter in the fourth quarter of 2014, down from 1.2 percent in the previous quarter, mainly reflecting a negative contribution from net trade. Recent indicators suggest a minor but temporary slowdown in the first quarter of 2015, largely owing to cold weather and port disruptions. However, consumption remains 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 percent 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 percent 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.

1.2 Macroeconomic Developments in Ethiopia

Fuel prices

During the third quarter of the fiscal year 2014/15, the average retail price of fuel products in Addis Ababa dropped 14.9 percent to 15.76 Birr/liter from 18.51 Birr/liter in the same quarter of last year following the reduction of fuel price in international market. Likewise, the retail prices fell 12.4 percent compared with the 18.00 Birr/liter registered in the preceding quarter.

Inflation

During the review quarter, headline inflation scaled up to 2.3 percent from 0.4 percent a year earlier and 1.0 percent vis-a-vis the previous quarter. The 1.9 percentage point year–on–year increase was due to 4.0 percentage point hike in food & non-alcoholic beverages inflation which offset 0.4 percentage point slowdown in non-food inflation. In the review quarter, non-food inflation contributed 1.3 percent to the headline inflation while that of food & non alcoholic beverage inflation was 1.0 percent.

Monetary Developments

Broad money supply (M_2) reached Birr 349.2 billion during the third quarter of 2014/15, showing a quarterly growth rate of 7.2 percent and year-on-year expansion of 27.7 percent. The annual growth in broad money supply was mainly driven by 30.0 percent surge in domestic credit, which offset 5.1 percent slowdown in NFA. The growth in domestic credit was attributed to a 32.2 percent increase in credit to non-central government in contrast with 3.0 percent moderate rise in net credit to the central government.

Reserve money reached Birr 95.3 billion at the close of the third quarter of 2014/15, depicting a yearly expansion of 12.8 percent while excess reserves of commercial banks decreased by 53.0 percent to Birr 4.7 billion.

The money multiplier measured by the ratio of broad money to reserve money, grew by 13.2 percent against last year same quarter implying the improvement of the monetization of the economy.

Interest rate

Average savings deposit and lending rates remained unchanged at 5.4 and 11.88 percent, respectively. Weighted average time deposit rate, however, slightly rose 0.2 percentage points quarter-on-quarter basis. The weighted average yield on T-bills also slightly increased from 1.26 to 1.29 percent over the previous year same quarter.

Considering annual headline inflation of 8.6 percent in March 2015, all deposit rates and T-bill yields 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 financial system. The number of banks existing in the country was 19 as of March 2015, which 16 banks are private. During the review quarter, 134 new bank branches were opened increasing the total number of bank branches to 2,636. Consequently, bank branch to population ratio went down to 1:34,171.5 from 1:41,088 last year same quarter, partly reflecting annual improvement in financial service outreach. About 35.4 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 private banks increased to 57.9 percent from 53.8 percent a year earlier as they opened 392 new branches compared to 136 by public banks.

Meanwhile, total capital of the banking system went up by 19.0 percent over last year same quarter and reached Birr 30.5 billion of March 2015 of which 55 percent was that of private banks. Commercial Bank of Ethiopia, the state owned bank accounted for 35 percent of the total capital of the banking system while the other two public banks, namely Development Bank of Ethiopia and Construction & Business Bank held 10 percent.

The number of insurance companies in Ethiopia stood at 17 of which 16 were privately owned. These insurance companies had 369 branches of which, about 53.4 percent are located in Addis Ababa. Likewise, their total capital increased by 34.7 percent on quarter-on-quarter basis and reached Birr 2.5 billion of which 81.1 percent is that of private insurance companies.

At the same time, 33 micro-finance institutions (MFIs), which jointly mobilized a total saving deposit of around Birr 14.2 billion, are operating in Ethiopia. Their saving deposit surged by 40.1 percent compared with last year same quarter. Similarly, their outstanding credit scaled up by 31.8 percent to reach Birr 18.7 billion and their total assets increased by 28.0 percent to reach Birr 29.0 billion during the same period.

All in all, total resources mobilized by the banking system decreased by 4.4 percent quarter-on-quarter on account of a decline in net deposit.

During the review quarter, total new loans of the banking system reached Birr 22.6 billion, reflecting a 45.4 percent quarter-on-quarter surge of which public banks disbursed Birr 16.4 billion (72.8 percent) while the remaining balance was disbursed by the private banks. About 100 percent of new loans disbursed by the private banks and 57.9 percent of the loan disbursed by public banks went to the private sectors (including cooperatives).

The banking system collected Birr 13.0 billion, up by 5.7 percent over last year same quarter of which private banks collected Birr 7.1 billion (55.0 percent) and public banks Birr 5.9 billion (45.0 percent). Of the total loan collection, 87.2 percent was from private enterprises.

Total outstanding credit of the banking System (excluding credit to the government and interbank lending) increased to Birr 205.7 billion at the end of March 2015, up by 7.1 percent on quarterly basis. About 99.9 percent of the outstanding loan of private banks was claims on private enterprises including cooperatives and 0.1 percent on public enterprises. On the other hand, 49.0 percent, of public banks' outstanding loan was claims on public and 51 percent on private enterprises.

External Sector and Foreign Exchange Developments

Total merchandise export decreased by 16.6 percent compared to same quarter last year and amounted to USD 820.8 million. This was on account of the slowdown in the export earnings from oilseeds (42.2 percent), gold (6.7 percent), chat (11.7 percent), pulses (24.8 percent), flower

(7.5 percent), live-animals (49.8 percent) and fruit & vegetables (1.6 percent) due to a decrease in international price, volume of export or both outweighing modest increase in revenue from coffee (3.4%), leather and leather products (7.1%), meat and meat products (35.8%) and electricity (14.1%).

Mean while, total value of merchandise import reached USD 4.2 billion, revealing a 13.9 percent quarter-on-quarter increase owing to the surge in import value of capital goods (34.2 percent), consumer goods (33.3 percent) and semi-finished goods (3.7 percent) offsetting a fall in imports of fuel (43.7 percent) and raw materials (0.2 percent).

During the review quarter, total net transfer receipts declined by 4.0 percent compared to last year same quarter and amounted to USD 1.2 billion as official transfers decreased by 40.6 percent. Net private transfers, however, registered a 5.2 percent growth and stood at USD 1.1 billion on account of the 27.4 percent surge in cash remittances from private individuals and 8.8 percent rise in transfer of NGOs.

The current account balance (including official transfers) had a deficit of USD 2.3 billion, which was higher than USD 1.4 billion deficit recorded a year earlier. The widening current account deficit was attributed to lower net services receipts, net official transfers and poor exports.

In contrast, the capital account recorded USD 926.3 million in surplus; about 97.1 percent higher than last year same period. This was due to higher inflows of net official long-term capital (36.6 percent) and foreign direct investment (48 percent).

As for exchange rate developments, the average official exchange rate of Birr with respect to USD depreciated by 5.4 percent compared to last year same quarter and reached Birr 20.2145/USD. Likewise, in parallel market, the average exchange rate stood at Birr 22.8861/USD showing a 15.5 percent depreciation vis-à-vis last year same quarter. As a result, the premium in the parallel market widened to 13.2 percent from 3.3 percent last year.

Mean while, the REER, an indicator of Ethiopia's external sector competitiveness, appreciated both quarter-on-quarter and quarterly by 5.7 percent and 6.6 percent, respectively, essentially due to relatively faster nominal exchange rate deprecation and low inflation in Ethiopia's major trading partner countries. Likewise, NEER appreciated by 2.4 percent and 1.4 percent compared with the preceding quarter and last year same quarter.

Federal Government Fiscal Operations

Total revenue and grants collected by the Federal government amounted to Birr 30.9 billion during the third quarter of 2014/15, about 11.2 percent higher than the same quarter last year while its total expenditure declined by 4.5 percent and stood at Birr 31.8 billion.

As a result, the overall fiscal balance of the federal government (including grants) showed Birr 869 million deficit which was significantly lower than Birr 5.4 billion a year earlier.

Investment

During the second quarter of 2014/15 the Ethiopian Investment Agency (EIA) and Regional Investment Offices licensed a total of 14 projects with a total investment capital of Birr 73.9 million. The number of investment projects and investment capital rose by 75 and 314.8 percent, respectively, year-on-year basis.