# IX. INTERNATIONAL ECONOMIC DEVELOPMENTS

## 9.1 Overview of World Economy[1/]

The global economy, in which activity has started to recover, continues to show stronger signs of a return to growth. Having returned to positive growth in the second and third quarters of 2009, global economic activity also continued to expand in the final quarter in several advanced and emerging economies. However, the pace of the recovery is becoming increasingly divergent across countries. The return to growth has been helped by the monetary and fiscal policy stimuli and by improvements in both consumer and business confidence as well as by a prolonged inventory cycle. Positive developments in global economic activity have also been accompanied by a quick recovery in world trade.

In the United States, economic growth accelerated in the fourth quarter of 2009, after having turned positive in the previous quarter, as economic conditions continued to improve. According to the advance estimate published by the Bureau of Economic Analysis, real GDP rose by 5.7% in annualized terms in the fourth quarter of 2009, the highest increase in more than six years. The main driver of the pick-up in activity was a less pronounced pace of inventory liquidation. In addition, private consumption contributed positively to growth, albeit less than in the previous quarter. Investment in residential property continued to increase, and business investment rose for the first time in more than one year. Net exports also contributed positively to growth, as the strong export growth exceeded that of imports.

The recovery in Japan also continued in the fourth quarter of 2009, with growth being driven not only by external demand, but also by a pick-up in domestic demand. According to the second preliminary data release by Japan's Cabinet Office, real GDP expanded by 0.9% quarter on quarter in

[1/] Sections 6.1 – 6.4 are excerpted from European Central Bank's Monthly Bulletins, February and April, 2010 the fourth quarter. Growth in the third quarter was revised downwards to negative figures.

According to Eurostat's second estimate, euro area real GDP was stable in the final quarter of 2009, compared with a quarter-on-quarter increase of 0.4% in the previous three-month period. The pause in real GDP growth in the fourth quarter of 2009 confirms that the euro area recovery is likely to follow an uneven path, after five consecutive quarters of GDP contraction from the second quarter of 2008 to the same quarter of 2009. Looking ahead, euro area real GDP is expected to continue to expand at a moderate pace in the current year, as low capacity utilization rates are likely to dampen investment, and weak labour market prospects in the euro area are expected to reduce consumption growth.

In the United Kingdom, quarter-on-quarter real GDP growth turned positive in the fourth quarter of 2009, after a gradual moderation in the pace of decline in the previous quarters. According to the revised estimate, real GDP increased by 0.3% in the fourth quarter of 2009, compared with a 0.3% decrease in the third quarter. GDP growth was mainly driven by household expenditure, which increased by 0.4% quarter on quarter, and by government final consumption, which rose by 1.2%, while business investment continued to decline. Overall, recent activity and housing market indicators suggest that the gradual improvement in the economic situation has continued in early 2010. In the housing market, the positive trend has been sustained in recent months, on the back of supportive policy measures. In January house prices increased for the seventh consecutive month (by 3.6% year on year), in line with the improvement in mortgage credit availability in recent months.

Overall, the economic situation has also improved in the other non-euro area EU countries in recent quarters. However, quarter-on-quarter real GDP growth dynamics have been fairly volatile in a number of countries, reflecting fluctuations in the inventory cycle and ongoing fiscal adjustment. In Sweden, real GDP declined by 0.6% quarter on quarter in the fourth quarter of 2009, according to the flash estimate. The historical data were revised downwards, now indicating stagnation in the second quarter and a contraction of 0.1% in the third quarter. In Denmark, the flash estimate suggests that real GDP increased by 0.2% in the fourth quarter, following a 0.3% increase in the third quarter (revised downwards from 0.6% previously).

In the largest central and eastern European EU Member States, the economic situation has improved considerably since the sharp fall in activity observed in the first quarter of 2009. The strong recovery in industrial production in recent months, supported by the improvement in external demand, has played a key role. Across the region, real GDP growth improved gradually in the second and third quarters (in quarter-on-quarter terms), although there was only a moderation in the pace of decline in Hungary and Romania. In the final quarter of 2009, however, growth patterns were more diverse, according to Eurostat's flash estimates. While the pace of decline moderated further in Hungary to -0.4% (up from -1.2% in the third quarter), the decline accelerated in Romania to -1.5% (compared with -0.6% in the third quarter), and growth turned negative in the Czech Republic at -0.6% (down from growth of 0.8% in the third quarter). In Poland, quarter-on-quarter real GDP growth accelerated in the fourth quarter, standing at 1.2%.

In Russia, available data indicate that output has continued to recover in the fourth quarter from its contraction in the first half of 2009. Overall, real GDP contracted by 7.9% in 2009, according to preliminary estimates. Industrial production figures available for January 2010 suggest that the rebound in economic activity might have lost momentum in early 2010, as the authorities are gradually phasing out the fiscal stimulus provided in 2009. Further risks to a swift recovery mainly stem from weaker than expected commodity prices and subdued credit growth.

In emerging Asia, the expansion of economic activity accelerated further in the last quarter of 2009, thereby continuing to lead the global recovery. This was mainly a result of the fiscal stimulus packages. Moreover, foreign trade is also gradually recovering and moving closer to its pre-crisis level in most countries. Domestic demand is increasingly becoming self-sustained, with favorable asset market developments and a rebound in employment creation.

In China, year-on-year real GDP growth accelerated to 10.7% in the last quarter of 2009, resulting in output growth of 8.7% in 2009 as a whole. Stimulus-driven investment remained the main source of growth. Despite a gradual improvement in external conditions, the contribution of net trade remained negative in the last quarter of 2009. In Korea, real GDP growth accelerated sharply to 6% in year-on-year terms in the last quarter of 2009, compared with 0.9% in the previous quarter, largely owing to base effects. The contribution to growth from private consumption and investment increased further. Economic activity has also been robust in India where real GDP rose by 5.9% year on year in the last quarter of 2009, compared with 6.8% in the third quarter.

The pace of economic activity in Latin America accelerated further in the fourth quarter of 2009. In Brazil, high frequency indicators suggest that growth in both domestic and external demand accelerated significantly in the fourth quarter. In Argentina, industrial production rose by 5.2% in the fourth quarter of 2009, following a contraction of 1% in the previous quarter. In Mexico, real GDP contracted by 2.4% year on year in the fourth quarter of 2009, following a contraction of 6.1% in the third quarter.

The world economy is poised for further recovery but at varying speeds across and within regions. Global growth is projected to reach 4.2 percent in 2010 and 4.3 percent in 2011, following a 0.6 percent contraction in 2009. Advanced economies are now expected to expand by 2.3 percent in 2010 and by 2.4 percent in 2011, following a decline in output of more than 3 percent in 2009. Growth in emerging and developing economies is projected to be over 6 percent during 2010–11, following a modest growth of 2.4 percent in 2009.

Sub-Saharan Africa has weathered the global crisis well, and its recovery from the slowdown in 2009 is expected to be stronger than following past global downturns. Although some middle income and oil-exporting economies were hit hard by the collapse in export and commodity markets, the region managed to avoid a contraction in 2009, growing by 2 percent last year. Its growth is projected to accelerate to 4.7 percent this year and to 5.9 percent in 2011.

The region's quick recovery reflects the relatively limited integration of most low-income economies into the global economy and the limited impact on their terms of trade, the rapid normalization in global trade and commodity prices, and the use of counter cyclical fiscal policies. Remittances and official aid flows have also been less affected than anticipated by the recessions in advanced economies. Banking sectors have so far proved generally resilient, and private capital inflows have resumed into the region's more integrated economies.

## 9.2 Inflation Developments

Global inflation has also moved back in positive territory, as the negative base effects associated with commodity price developments are turning positive. After remaining negative for four months, global inflation rates returned to positive territory in the last quarter of 2009 and recorded some further slight increases in early 2010. In the OECD countries, headline CPI inflation stood at 2% in the year to January, up from 1.9% in the year to December. The moderate increases in annual inflation rates over the past months mainly reflected the reversal of base effects related to commodity prices. Meanwhile, OECD inflation excluding food and energy stood at 1.6% in the year to January, unchanged from the previous month.

In the United States, the average annual CPI inflation rate in 2009 was -0.4%, down from 3.8% in 2008. Headline inflation picked up towards the end of 2009 and stood at 2.6% in January 2010, mainly owing to base effects stemming from past developments in energy prices. Excluding food and energy, annual CPI inflation slowed to 1.6% in January, down from an average of 1.7% in 2009.

Owing to considerable economic slack, consumer prices in Japan continued to decrease in January. Headline consumer prices fell by 1.3% in the year to January, following a year-on-year decline of 1.7% in December. Excluding food and energy, annual CPI inflation stood at -1.2% in January, unchanged from the previous month.

In United Kingdom, annual HICP inflation has increased in recent months, standing at 3.5% in January; up from

2.5% in December mainly as a result of higher oil prices and the expiration of the temporary decrease in the VAT rate. In addition, upward pressures resulting from the past depreciation of the pound sterling might have played a role. However, looking forward, inflation is expected to moderate as persistent spare capacity will exert a dampening influence on price dynamics.

Regional inflationary developments in other European countries have been rather diverse in recent months. Annual HICP inflation has been hovering at a fairly low level in the Czech Republic, standing at 0.4% in January. In contrast, in Hungary, Poland and Romania, annual HICP inflation has remained at higher levels, standing at 6.2%, 3.9% and 5.2% respectively in January. In Russia, inflationary pressures, while still high, have continued to ease. Annual consumer price inflation fell to 8.0% in January as earlier Rouble appreciation dampened import prices.

Annual consumer price inflation in China returned to positive territory in November 2009 and reached 1.5% in January 2010. The monetary authorities have begun to withdraw excess domestic liquidity by raising the banks' reserve requirement ratio twice since the beginning of the year, by 50 basis points on each occasion. In Korea, annual CPI inflation stood at 3.1% in January, up from 2.8% a month earlier. In India, wholesale price inflation, the Reserve Bank of India's main measure of inflation, has picked up strongly, mainly reflecting a rapid acceleration in food and fuel prices. In January, wholesale prices were 8.6% above their level one year earlier.

Inflationary pressures receded in most Latin America countries. In Brazil, retail sales increased, on average, by 8.8% year on year in the final quarter of 2009, compared with 5.0% in the third quarter. Annual CPI inflation stood at 4.2% in the fourth quarter, marginally lower than in the previous quarter. In Argentina, annual CPI inflation averaged 7.1% in the final quarter of 2009, up from 5.9% in the third quarter. Annual consumer price inflation in Mexico averaged 4% in the fourth quarter of 2009, down from 5.1% in the third quarter.

## 9.3 Commodity Price

After recovering rapidly from their crises lows in the second quarter of

2009, oil prices have largely remained range-bound since mid 2009, fluctuating between USD 70 to USD 80 per barrel. The bounded fluctuations have reflected opposing effects from the adjustment of oil demand and supply to the normalization of global economic and financial conditions respectively. Looking ahead, market participants are expecting higher oil prices in the medium term, with futures contracts for December 2011 trading at around USD 84 per barrel.

The stabilization of oil prices has come against the background of improving fundamentals. Oil demand has recovered from the lows recorded in the second quarter of 2009, mainly owing to the contribution of emerging economies. This increase in demand has also led to a decrease in the inventories accumulated in 2008. On the supply side, non-OPEC production has remained broadly unchanged, while OPEC is now producing well above its target. Meanwhile, the sequence of upward revisions to demand projections by the International Energy Agency has come to a halt. The latest demand forecasts for 2010 suggest an increase of 1.6 million barrels per day with respect to 2009, mainly attributed to growth in non-OECD demand.

The prices of non-energy commodities have decreased in the last three months. Food prices and prices of agricultural raw materials have moderated somewhat, driven, in particular, by reports of record corn crops. Looking at metal prices, the surge experienced in the last quarter of 2009 came to an end amid market concerns about the robustness of the global economic recovery.

Looking ahead, commodity prices are expected to rise a bit further supported by the strength of global demand, especially from emerging economies. However, this upward pressure is expected to be modest, given the above-average inventory levels and substantial spare capacity in many commodity sectors. Accordingly, the IMF's baseline petroleum price projection is unchanged for 2010 and revised up by a small amount in 2011 (to $82 a barrel, from $79 a barrel in the October 2009 WEO). Other non-fuel commodity prices have also been marked up modestly.

## 9.4.Exchange Rate Development

Following some fluctuation in October and November, the nominal effective exchange rate of the euro – as measured against the currencies of 21 of the euro area’s most important trading partners – weakened in December. Over the last three months the depreciation of the euro has been rather broad based, and only slightly reduced by the appreciation of the euro vis-à-vis the Japanese yen.

While in October and November the euro continued to appreciate against the dollar, it weakened in December. This was part of a relatively broad-based appreciation of the US dollar against major currencies. Market uncertainty, as measured by the implied volatility at the three-month horizon, initially increased, stabilized somewhat in late 2009.

Over the last three months the exchange rate of the euro vis-à-vis the Japanese yen has continued to fluctuate within a range of JPY 129 to JPY 138 to the euro. After increasing in October and November, the implied volatility of the JPY/EUR exchange rate fell, reaching values closer to its long-term average.

The euro weakened slightly against the pound sterling in the fourth quarter of 2009. On 13 January the euro was 1.6% weaker vis-à-vis the pound sterling than at the end of September and close to its 2009 average. Since November the implied volatility of the GBP/EUR exchange rate has decreased sharply, particularly at the one and three-month horizons. Since the end of September the euro has weakened against the Polish zloty (by 4.1%), the Romanian leu (by 2.4%) and the Hungarian forint (by 1.1%), strengthened against the Czech koruna (by 4.0%) and remained broadly unchanged vis-à-vis the Swedish krona.

In October and November the euro remained rather stable vis-à-vis the Swiss franc, at around CHF 1.51. In December, following a change in its communication on exchange rate policy by the Swiss National Bank, the Swiss franc strengthened against the euro, by around 2%, to reach CHF 1.48 to the euro on 13 January. Over the same period the bilateral euro exchange rates vis-à-vis the Chinese renminbi and the Hong Kong dollar followed the developments in the USD/EUR exchange rate. The euro also weakened against major commodity currencies, such as the Canadian dollar (by 4.1%), the Australian dollar (by 5.2%) and the Norwegian krone (by 3.3%).

**9.5 Impact of Global Economic Development on Ethiopian Economy**

The global recovery is off to a stronger start than anticipated earlier but is proceeding at different speed in the various regions. Following the deepest downturn in recent history, economic growth solidified and broadened to advanced economies in the second half of 2009.

In response to global economic recovery, Ethiopian external sector has started to revive. Earnings from merchandise exports, which fell by 1.2 percent in 2008/09 and 2.6 percent in the first quarter of 2009/10 due to lower volume and international prices, rebounded by 8.2 percent in the second quarter of 2009/10 relative to the preceding quarter.

Similarly, receipts from private transfers, which had dropped by 6.2 percent in the first quarter, rose by 4.2 percent in the second quarter of 2009/10. Foreign direct investment and remittance transfers have also improved.

In short, the multi-speed of global recovery across regions is expected to have a positive impact on Ethiopia's export sector, tourism, private remittance and FDI inflows. At the same time, demand for imports and higher commodity prices, particularly fuel, capital goods and raw materials in the global market is likely to put pressure on the country's balance of payments, gross international reserves and domestic inflation. Cognizant of this fact, the government is taking concerted monetary and fiscal policy measures to attain macro economic stability and sustained growth through 2009/10.