I. OVERVIEW

1.1 International Economic Developments and their Impact on Ethiopian Economy

The world economy has continued to revive in the second quarter of 2009/10 after a two year long (2008-09) contraction. The economic recovery witnessed in advanced and emerging economies is evidenced by a slight increase in economic growth, rise in domestic and external demand, improvement in trade balance, gradual increase in inflation to positive territory, among others. Sub-Saharan economies have also exhibited recovery after some middle income and oil exporting countries were hit by the crisis. Oil prices which were between USD 70 and USD 80 per barrel in the month of October 2009 are estimated to increase to around USD 84 per barrel in December 2011, as a result of surge in international oil demand from emerging economies. Commodity prices are also expected to increase.

Following the continued global economic recovery, the Ethiopian external sector, in the second quarter of 2009/10, has shown improvement as witnessed by 8.2 percent export growth over the level in end September 2009, owing to an increase in both volume of export and international price. There has also been a 26.3 percent quarterly and 4.2 percent annual growth in receipts from private transfers (including remittances) in contrast to 2.7 percent quarterly and 6.2 percent annual decline and besides development has been seen in FDI inflows. Such a positive development is expected to continue as international demand for export and commodity prices tend to improve. The continuous strengthening of economic activity in advanced and emerging economies is expected to have a positive effect on the country's FDI inflows, remittances and tourism receipts. On the other hand, the growing import demand and higher price for imports such as fuel, capital goods etc are expected to put pressure on the country's BOP and international reserves in the months a head.

1.2 Performance of Ethiopian Economy during Second Quarter of 2009/10

The second quarter of 2009/10 witnessed 0.6 percent headline inflation, which was 5 percentage points higher than a year ago while 2.5 percentage points lower than preceding quarter. The yearly growth in headline inflation was on account of a 6.2 percentage points rise in food inflation and particularly spices, coffee and potatoes.

Broad money supply (M_2) showed quarterly and annual growth rates of 2.6 and 20.1 percent, respectively to Birr 91 billion in the quarter under review, owing to substantial increase in net foreign assets and marginal expansion in net domestic credit, largely credit to non-government sectors.

Reserve money declined by 1.5 percent to Birr 46.2 billion relative to the preceding quarter, due to a 14.9 percent drop in commercial bank's deposit at NBE, which more than offset the 12.7 percent rise in currency in circulation. Year-on-year basis, however, reserve money expanded by 16 percent as currency in circulation grew by 23 percent and banks deposits at NBE rose by 8.4 percent.

Regarding interest rate, the average saving deposit rate and lending rates remained unchanged at their respective levels of 4.5 and 12.25 percent in September 2009 while the weighted average demand deposit and average time deposit rates depicted a quarterly decrease of 7 and 0.3 percent, in their order. Likewise, weighted average yield on T-bills went down to 0.778 percent from 0.886 percent a year ago. The average bond yield remained at 4.5 percent.

In relation to financial sector development, the number of banks operating in the country increased by 1 to 15 while the number of insurance companies remained at the previous quarter level of 12. In terms of branch expansion, 12 new bank branches and 5 new insurance branches were opened in the stated period, raising the total number of bank and insurance branches in the country to 663 and 201, respectively.

The number of microfinance institutions also rose by 2 to reach 30 and their total outstanding credit extended to beneficiaries went up by 2 percent to Birr 5.1 billion relative to end September 2009.

Total resources mobilized by the banking sector dropped by 15.6 percent to Birr 8.8 billion in the review quarter in contrast to a year ago, due to slow down in net deposits and net borrowing outweighing the rise in collection of loan. Disbursement of fresh loans also lifted up by 13.8 percent to Birr 7.3 billion.

In the foreign exchange market, the exchange rate of Birr against USD was Birr 12.5851, about 1.7 and 27.6 percent weaker on quarterly and annual basis, respectively. Meanwhile, the exchange rate of the Birr against USD in the parallel market reached 13.3933. Hence, the spread between official and parallel market rates narrowed to 6.42 percent from 7.42 percent in preceding quarter, owing to a 10 percent depreciation of the Birr in August 2009.

With respect to external sector development, quarterly export proceeds reached USD 370.4 million, about 36.7 percent higher than last year. The remarkable growth was attributed to a rise in earnings from all export commodities except leather and leather products. Similarly, imports went up by 19.4 percent to USD 2.32 billion due to a quarterly surge in import payments of semi finished goods (26.2 percent), fuel (48.6 percent) and capital goods (51.4 percent). Thus, merchandise trade deficit widened by about 16.6 and 36.1 percent compared to a year earlier and the previous quarter, respectively.

Total net transfers slightly declined to USD 1.25 billion from USD 1.29 billion last year, as a result of 13.9 percent fall in official transfers offsetting a 4.3 percent increase in private transfers. Year-on-year basis, remittance inflow peaked up by 7.5 percent. Service account also exhibited a surplus of USD 216 million, 32.6 percent higher than in the preceding quarter. All in all, the current account balance in the period depicted a wider deficit of USD 477.8 million while the capital account registered a significant surplus of USD 778.2 million, resulting in USD 87 million BOP surplus.

The review period also witnessed a growth in government fiscal operations. Revenue and grants reached Birr 15 billion while government expenditure was Birr 14.9 billion. This resulted in a fiscal surplus of Birr 111.9 million, significantly lower than last year same period, owing to lower grants. On quarterly basis, total revenue and grant rose by 28.9 percent.

The number of investment projects licensed during the second quarter of 2009/10 reached 1,678 and their aggregate capital was Birr 21.2 billion. Most of the investment projects are in agriculture, hunting and forestry sector, constituting 23 percent.