VIII. INTERNATIONAL ECONOMIC DEVELOPMENT

8.1. Overview of the World Economy[1/]

The recovery of the world economy remains fragile. The information that has become available over the past few months confirms that there has been a gradual pick-up in global activity. For the OECD area, provisional estimates show that–amid continued divergence–quarterly GDP grew by 0.4% in the third quarter of 2011/12 F.Y., up from 0.3% in the previous quarter. In the third quarter, global activity was temporarily supported by improving global financial conditions, which have nevertheless deteriorated in recent weeks amid concerns about certain euro area economies. The weakness in the labour and housing markets in major advanced economies as well as the need to repair balance sheets are likely to continue to act as an impediment to the pace of growth in the global economy. While a rebalancing of private sector indebtedness is progressing, the debt levels of households remain elevated in a number of major advanced economies. In emerging economies, while growth has been moderating somewhat on account of past policy tightening and weaker internal and external demand, it remains solid overall, thereby contributing significantly to global economic growth.

In all major non-euro area advanced economies – with the exception of the United Kingdom – there has been further evidence of a modest expansion in overall economic activity. At the global level, growth in industrial production also rebounded in the third quarter of 2011/12 F.Y.

Consistent with global activity, world trade picked up modestly in the third quarter of 2011/12 F.Y. World trade in goods increased by 1.6% in the first quarter (quarter on quarter), after stalling in the second quarter of 2011/12 F.Y. This recovery was supported by fairly buoyant growth in major emerging market regions, partly reflecting a normalization of supply-chain linkages, which were disrupted following the floods in Thailand. At the same time, external trade dynamics in the main

[1/] Section 7.1 excerpted from European Central Bank, June 2012 monthly bulletin while others are taken from May 2012.

advanced economies remained rather sluggish. The latest survey indicators point towards some loss in momentum of global trade in the near term.

In the United States, the expansion in economic activity is proceeding at a moderate pace. Real GDP increased at an annual rate of 1.9% (0.5% quarter on quarter) in the first quarter of 2012, down from 3% in the previous quarter. Growth in the first quarter was primarily supported by personal consumption expenditures, which were in part financed via a drawdown of the personal saving rate, given subdued income growth. Survey-based indicators and high-frequency data point to an ongoing moderate expansion in the fourth quarter of 2011/12.

In Japan, real GDP growth expanded by 1% quarter on quarter in the third quarter of 2011/12 F.Y., after stagnating in the previous quarter. The main contributions to growth came from private consumption and public spending, together with changes in private inventories. Private consumption increased by 1.1%, partly reflecting the reintroduction of government incentives to purchase environmentally-friendly cars as well as pent-up demand, while the strength in public spending mainly reflected robust growth in public investment, confirming that reconstruction-related public spending is picking up. On the other hand, private investment contributed negatively to growth, as both private business and residential investment fell on a quarterly basis. Net exports of goods and services contributed modestly to growth, with solid growth in exports reflecting to some extent the recovery from the supply-side disruptions caused by the floods in Thailand.

In the United Kingdom, Real GDP declined by 0.3% quarter on quarter in the third quarter of 2011/12 F.Y., with both investment and household consumption making a negative contribution to growth. The labour market situation has shown signs of stabilization, but the unemployment rate is still relatively high (8.2% on average in the three months to March) and employment growth has been subdued. Looking ahead, the economic recovery is likely to gather pace only gradually, as domestic demand is expected to remain constrained by tight credit conditions, ongoing household balance sheet adjustments and substantial fiscal tightening.

Within non-euro area EU countries, the recovery of economic activity in Sweden and Denmark gained some momentum after fading in the second quarter of 2011/12 F.Y. In Sweden, real GDP increased by 0.8% quarter on quarter in the third quarter of 2011/12 F.Y. and in Denmark by 0.3%, driven by domestic demand in both countries. In the largest central and eastern European (CEE) countries, economic activity has been weak recently. In the third quarter of 2011/12 F.Y., real GDP declined in the Czech Republic, Hungary and Romania by 1%, 1.3% and 0.1% quarter on quarter, respectively, while growth continued in Poland (0.8%). Overall, the economic outlook has stabilized somewhat in the largest CEE countries after worsening during the winter; however, the recovery is likely to be very gradual, and the situation varies from country to country. Weak foreign demand, sluggish recovery in labour markets and ongoing fiscal consolidation are likely to weigh on activity in the short term.

In emerging Asia, economic activity slowed in the third quarter of 2011/12 F.Y., led by weakening exports and investment. Export growth moderated in the first quarter, mainly reflecting sluggish demand from Europe, while investment remained weak as a result of a heightened volatility of capital flows and the lagged effects of a tightening of domestic monetary policies. Nonetheless, the adverse impact from the global headwinds was partly offset by resilient consumption.

In China, real GDP growth decelerated to 8.1% year on year in the first quarter of 2012, down from 8.9% in the second quarter of 2011/12 F.Y. External conditions remained weak, mainly on account of sluggish demand from the euro area. Accordingly, export growth fell to 8.9% year on year in the first quarter and to 4.9% year on year by end-April. The current account surplus declined to 1.4% of GDP in the third quarter of 2011/12 F.Y., from 2.7% in 2010/11 F.Y. Domestic demand growth also slowed, with data indicating an increasing role for consumption as the main source of growth. The property sector appears to be cooling off on account of the tightening policies, although the authorities' social housing program is partially compensating for lower private sector investment.

In India, real GDP growth moderated to 5.6%, year on year, in the third quarter of 2011/12 F.Y. (from 6.2% in the second quarter of 2011/12 F.Y.). Private consumption growth decelerated to 6.1%, while growth in investment and exports accelerated to 3.6% and 18.1%, respectively. In Korea, real GDP growth moderated to 2.8%, year on year, in the third quarter of 2011/12 F.Y., compared with 3.4% in the second quarter of 2011/12 F.Y. Net exports contributed significantly to the deceleration, while growth in investment and government expenditure accelerated to 5.1% and 4.4%, respectively.

In the group of the ASEAN-5 countries (Indonesia, Malaysia, the Philippines, Singapore and Thailand), Indonesia's economy continued to grow strongly by 6.3% year on year in the third quarter of 2011/12 F.Y., on account of resilient investment and private consumption. GDP growth in Malaysia and Singapore decelerated to 4.7% and 1.6% respectively, year on year, in the first quarter, driven mainly by net exports and government expenditure. Economic activity in Thailand rebounded to 0.4% year on year in the third quarter of 2011/12 F.Y. from the significant contraction (-8.9% year on year) in the second quarter of 2011/12 F.Y., following the worst floods in recent history. Looking ahead, emerging Asia's economic growth is expected to remain resilient, with subdued external demand being compensated for by solid private consumption.

Despite the strong gains in oil production in a number of Middle East and Africa countries, high oil prices persisted in the third quarter of 2011/12 F.Y. and supported economic activity in the oil-exporting countries. In addition to higher oil output, expansionary fiscal policies and stronger private consumption contributed to growth. In response to the heightened uncertainty about global oil supply in recent months, Saudi Arabia held production at a very high level. Moreover, the economy continued to gain momentum, not only on account of strong oil exports but also on account of robust consumer demand and public spending. Elsewhere in the region, with a few exceptions, strong economic performance also continued, despite the weaker external environment. The factors that supported growth were still strong (non-oil) commodity prices and generally accommodative macroeconomic policies.

The economic activity in Brazil cooled down at the start of the third quarter, following a trend that started in late 2009/10 F.Y. Real GDP grew by 0.7% year on year in the third quarter of 2011/12 F.Y., from a peak of 9.1% at the start of the second half of 2009/10 F.Y. and an average of 2.7% in 2011. The slowdown was particularly pronounced in the manufacturing sector in the second half of last year, followed by a significant decline at the start of 2012. In Argentina, indicators of economic activity also showed increasing signs of a slowdown after the exceptionally high growth rates recorded over the past two years. Indeed, real GDP growth stood at 7% in the fourth quarter of 2011, having stood at rates of around 10% in many previous quarters. Real GDP growth in Mexico, increased to 4.7% in the first quarter of 2012, compared with 3.9% in the last quarter of 2011. Growth was supported by favourable labour market developments, external demand from the United States and, more generally, gains in competitiveness. Looking ahead, the expected improvement in global demand should support growth dynamics in the region. Domestic demand is anticipated to be the main engine of growth, while south-south trade dynamics are expected to support export growth.

8.2. Inflation Developments

Global inflation has eased in recent months and inflationary dynamics remain contained in advanced economies. In March, annual headline inflation in the OECD area moderated to 2.7%, compared with 2.8% in the previous month, continuing the gradual decline from its peak of 3.3% recorded in September 2011. Base effects reflecting the annual rate of change in the energy component of consumer price indices partly account for this. Annual inflation excluding food and energy remained at 1.9% in March, unchanged from the previous few months. In emerging economies, inflation rates have declined lately, although inflationary pressures are greater in view of tighter capacity buffers.

Annual CPI inflation in United States slowed further to 2.7% in March, representing more than a full percentage point decline from its peak of 3.9% in September 2011. The deceleration reflects the continued easing in the annual rate of change in energy prices, partly owing to base effects, and to a lesser extent in food prices. Excluding food and energy, annual inflation edged up to 2.3% in March, from 2.2% in the previous month. Shelter costs, which have been recovering from negative annual rates of change in 2010, have more recently steadied to a pace consistent with annual increases of close to 2%.

In Japan, annual CPI inflation edged up in March to 0.5% (from 0.3% in the previous month), owing to a large extent to increases in energy prices and some technical factors. Annual CPI inflation excluding fresh food also increased from 0.1% in February to 0.2% in March, while the annual rate of change of CPI inflation excluding food and energy remained at -0.5%.

The annual CPI inflation in United Kingdom increased to 3.5% in March from 3.4% in February, while CPI inflation excluding energy and unprocessed food remained unchanged at 2.9%. Inflation is likely to decline slightly further in the short term. In the longer term, the weak economic outlook and the existence of spare capacity will probably contribute to a further dampening of inflationary pressures.

In emerging Asia, annual inflation rates moderated further in the first quarter of 2012, owing to the weak economic activity and the stabilization of global commodity prices. In the light of decreasing inflationary pressures and downside risks to the economic outlook, some central banks in the region recently took measures to ease monetary policy. Annual CPI inflation in China picked up moderately to 3.6% in March, from 3.2% in February, on account of a temporary increase in food prices. Nonetheless, for the first time since October 2010, the CPI inflation rate stayed below the authorities’ 4% target for a second consecutive month.

Consumer price inflation in several Middle East and Africa countries was slightly higher in the first three months of 2012 compared with the previous quarter. In Saudi Arabia, consumer price inflation increased to 5.4% year on year in the first quarter of 2012, from 5.2% in the previous quarter, driven by food prices. In most oil-importing countries, inflation remained stable in the first quarter of 2012.

In Brazil, inflationary pressures, albeit declining, remain elevated, with annual inflation standing at 5.7% in the first quarter of 2012. Annual CPI inflation in Argentina remained close to double-digit levels in the first quarter of 2012 while annual consumer price inflation in Mexico, stood at somewhat higher levels than in the preceding quarters, averaging 3.8% in the first quarter of 2012.

8.3. Commodity Market

Oil prices declined in April 2012. Brent crude oil prices stood at USD 119.5 per barrel on 2 May 2012, which is 3% lower than at the beginning of April, but still 11.1% higher than at the beginning of the year. Looking ahead, market participants expect lower oil prices in the medium term, with futures contracts for December 2013 trading at USD 109.2 per barrel.

The recent decline reflects a combination of factors. First, there have been some concerns among market participants about the global economic outlook, as recent macroeconomic data releases in several major economies were mixed. Moreover, the first quarter of this year saw the first signs of easing market fundamentals in more than two years, according to the International Energy Agency’s latest Oil Market Report. This was mainly due to robust growth in OPEC supply alongside relatively sluggish oil demand, while there was a more mixed performance in non-OPEC supply. Finally, market speculation about a potential strategic stock release, together with assurances by Saudi Arabia that it will maintain a stable oil supply, appear to have increased market confidence in the ability of suppliers to compensate smoothly for a future decline in Iranian oil exports.

On aggregate, prices of non-oil commodities were broadly flat in April. While metal prices were negatively affected mainly by concerns about global growth, food prices increased, on aggregate, as a result of further strong supply-driven increases in the prices of oilseeds and oils. By contrast, prices of cereals and of beverages, sugar and tobacco declined further. On aggregate, the price index for non-energy commodities (in US dollar terms) was about 6.5% higher towards the end of April than at the beginning of the year.

8.4. Exchange Rate Developments

Between the end of January and early May 2012 the effective exchange rate of the euro remained broadly unchanged in an environment of steadily declining volatility. On 2 May 2012, the nominal effective exchange rate of the euro, as measured against the currencies of 20 of the euro area's most important trading partners, was close to the level prevailing at the end of January 2012 and 4.4% below its average level in 2011.

In bilateral terms, over the past three months, the euro has been broadly stable against major currencies. Between 31 January and 2 May 2012 the euro depreciated against the US dollar by 0.3%, amid fluctuations that reflected changes in market sentiment with regard to developments in some euro area sovereign debt markets. The euro also depreciated slightly against the Swiss franc and the Chinese renminbi. Over the same horizon, the euro depreciated more strongly against the pound sterling by 2.8%, but appreciated significantly against the Japanese yen by 4.7%, amid the Japanese authorities' continued commitment to contain the appreciation of the Japanese yen. Vis-à-vis other European currencies, the euro broadly depreciated over the period under review, in particular against the Czech koruna, the Polish zloty and the Hungarian forint. Market volatility, as measured on the basis of foreign exchange option prices, has continued to decline since the end of January and currently stands below long-term average levels for most currency pairs.

8.5. Impact of Global Economic Developments on Ethiopian Economy

The external sector of Ethiopia depicted slow down during the review period largely in response of the global development in particular to the economic activities of advanced countries to which the Ethiopia economy is relatively integrated in terms of trade and investments. Accordingly, total merchandise export proceeds rose only by 7.7 percent year-on-year in the third quarter of 2011/12 (38.1 percent quarter-to-quarter) despite lower volume of major export products. In particular, total receipts from service exports mainly from travelers and individual cash remittances via the banking system contracted during the same period. However, FDI continued to involve in various sector of the economy as witnessed by the surge in estimated import of capital and other goods related to foreign investments.

On the other hand, the rise in international oil price relative to last year same period accounted largely for strong growth of total fuel import bills which utilized more than two-third of the total export revenue earned during the same period while the global developments importantly exerted a pressure on balance of payments development