I. OVERVIEW

International Economic Developments and their Impact on the Ethiopian Economy

The resurgence 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. 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 labor 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.

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 lighthearted growth in major emerging market regions, partly reflecting a normalization of supply-chain linkages, which were disrupted following the floods in Thailand.

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.

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.

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.

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 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.

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.

Macroeconomic Developments in Ethiopia

Inflation

During the third quarter of 2011/12 fiscal year, national general inflation increased to 5.2 percent from 4.6 percent in the second quarter on account of 1.0 and 0.3 percentage point surge in core and food inflation, but slowed down from 8.9 percent in the same quarter of last fiscal year. Quarterly food inflation increased to 5.1 percent from 4.8 percent during the previous quarter while non-food inflation picked up to 5.5 percent from 4.5 percent in the second quarter. Food inflation contributed 3.2 percent of the quarterly inflation and non-food 2.0 percent.

Fuel prices

Average international price of the crude oil was USD 103.04 per barrel, 11.7 percent down compared to the previous quarter. However, Addis Ababa average retail price of fuel remained at Birr 17.7 per liter during the quarter.

Monetary Developments

The stock of broad money supply (M2), measure of monetary aggregate in Ethiopia, reached Birr 171.5 billion at the close of the third quarter of 2011/12 revealing 10.0 and 31.6 percent quarterly and annual expansion, respectively. Net foreign asset was Birr 45.8 billion at the end of the review quarter, indicating 7.2 percent slowdown on annual basis but slightly increased by 0.3 percent vis-à-vis the previous quarter. On the contrary, net domestic credit, showed 16.3 and 120.2 percent growth over the stock at end of December 2011 and end of the review quarter to reach Birr 170.7 billion. Therefore, the 10 percent surge in broad money supply on quarterly basis was on account of an increase in net domestic credit; counter balancing the decline in net foreign asset. Annual increase in broad money supply on the other hand, was due to the surge in both net domestic credit and net foreign assets.

Base money/high powered money declined by 1.7 percent on annual basis to Birr 62.6 billion at the end of the quarter under review. Currency in circulation rose 19.4 percent compared to last fiscal year same quarter, Commercial banks' reserve at NBE scaled down by 31.7 percent vis-à-vis the same quarter last year. Therefore, the slowdown in reserve money both on annual and quarterly basis was due to the decline in banks' reserve at NBE despite an increase in currency in circulation. The money multiplier[1], measured by the ratio of broad money to reserve money or the inverse ratio of reserve requirement, increased from 2.0 percent at the end of March 2011 to 2.7 percent in the current quarter showing improvement in monetization process reflecting the positive role of the banking sector in financial development.

[1]The ratio of commercial bank's money to central bank's money under a fractional reserve banking system, it measures the maximum amount of commercial bank's money that can be created by a given unit of central bank's money.

Interest Rate

Setting the minimum savings and time deposit interest rate is one of the direct monetary policies of the NBE leaving lending rate to commercial banks. Accordingly, minimum saving deposit rate was raised from 4.0 percent to 5.0 percent effective December 1, 2010. As a result, all banks operating in the country have adjusted their deposit and lending rates thereof. Hence, the minimum and maximum saving deposit rates at the end of the quarter under review were 5.0 and 5.75 percent, respectively whereas the minimum and maximum lending rates stood at 7.5 and 16.25 percent showing no change over the previous quarter and last year same quarter. Considering 32.5 percent annual headline inflation in March 2012, average saving deposit rate (5.4 percent) and average lending rate (11.9 percent) were negative in real terms.

Financial Sector Developments

The number of commercial banks (including DBE) remained 17 at the end of March 2012. In the review quarter, 55 new bank branches were opened, thereby increasing the total number of bank branches to 1,181 (33.9 percent located in Addis Ababa) at the close of March 2012. Consequently, the ratio of total bank branch to total population has decreased to 67,739.2 from 71,048 in the preceding quarter, revealing a continuous development in financial service outreach in the country.

The number of insurance companies in the country reached 15 of which where 14 were privately owned companies. Their branches also increased to 232. Similarly the total number of MFIs remained at 31 during the quarter.

The total capital of the banking system reached Birr 17.5 billion at the close of December 2011, of which private banks together owned about 48 percent. Commercial Bank of Ethiopia, the giant state owned commercial bank, accounted for 35.6 percent of the total capital of the banking system.

Total resources mobilized by the banking system surged 25.7 percent on annual basis to Birr 25.6 billion at the end of the third quarter due to higher net deposit and loans collection by 65.4.

New loans disbursement by commercial banks including DBE, was Birr 14.6 billion, witnessing a 58.5 percent surge of vis-à-vis the same quarter of last year. Public banks disbursed Birr 10.9 billion (74.7 percent) while the balance of Birr 3.7 billion (25.3 percent) was taken up by private banks. About 96.9 percent of the new loans disbursed by private banks went to finance private enterprises.

In the review quarter, the banking industry collected loans to the tune of Birr 7.1 billion, which was 8.3 percent higher than the same quarter of last fiscal year. Of the total loan collection, private banks collected Birr 4.2 billion (89.2 percent) while public banks collected the remaining balance.

Total outstanding credit of the banking system (excluding interbank lending credit to the central government and bond sold by CBE) reached Birr 103.1 billion showing 15.4 percent increase over last year same quarter.

Total deposits mobilized by the banking system reached Birr 174.9 billion at the close of the third quarter of 2011/12, revealing annual increase of 35.0 percent. The growth in deposit mobilization was partly attributed to bank branch expansion and improvements in economic activities and income.

Similarly, MFIs mobilized a total of saving deposit of Birr 4.9 billion, which was 45.5 percent higher than the amount mobilized last year same quarter.

External Sector and Foreign Exchange Developments

Export earnings from merchandise goods increased by 38.1 percent over the last fiscal year, and amounted to USD 821.0 million in the third quarter of 2011/12 fiscal year. The annual growth of total exports was largely attributed to higher export earnings from live animals, oilseeds, fruits and vegetables, gold and flowers export revenue from leather & leather products and coffee tended to decline.

Meanwhile, total merchandise import bills during the review quarter was USD 3.1 billion, depicting 52 percent surge over last year same period as all of its components tended to show higher bill.

The services account recorded USD 54.0 million in net receipts against USD 230.0 million net receipts last year same period. The decline in net service receipts was largely due to higher payments for travel, transportation and communication at construction services.

The current account balance (including official transfers) registered USD 951 million deficits during the third quarter of 2011/12 compared to a surplus of USD 68.3 million last year same period owing to widening trade deficit, net service payments and a significant reduction in official transfers.

In the review quarter, the average official exchange rate of the Birr weakened by 1 and 4.1 percent with respect to the previous quarter and last year same period, respectively, to reach Birr 17.3107/USD. Meanwhile, the parallel average exchange rate stood at Birr 18.24/USD, illustrating a 2.3 and 6.6 percent depreciation on quarter-to-quarter and annualized basis respectively. As a result, the average premium between the official and parallel market rates widened to 5.4 percent from 4.0 and 2.8 percent the preceding quarter and last year same quarter, respectively.

Federal Government Fiscal Operations

Total revenue and grant mobilized by the Federal Government was Birr 21.5 billion. Year-on-year basis, it scaled up by 24.0 percent. The quarterly revenue and grant performance was 29.3 percent of the annual plan of fiscal year 2011/12.

Total Federal Government expenditures (including regional transfers) was Birr 26.3 billion, revealing annual surge of 31.8 percent and marginal decline of 0.16 percent quarter-on-quarter.

The Federal Government budget (including grant) depicted an overall deficit of Birr 4.8 billion, higher than Birr 3.3 billion deficit last year same period. The quarterly deficit was remarkably higher relative to the deficit a year earlier, due to higher growth in expenditure which counterbalanced the surge in quarterly revenue and grant collection.

Investment

The Ethiopian Investment Agency (EIA) and the Regional Investment Offices licensed a total of 1,065 investment projects with an aggregate capital of Birr 32 billion during the second quarter of 2011/12. The number of approved investment projects was 25 percent higher compared to same quarter of last fiscal year. Similarly, the total registered capital of these projects grew by 164 percent annually.