# I.OVERVIEW

## 1.1 International Economic Developments[1]

The world economy continues its gradual recovery largely due to structural impediments limiting the medium term growth outlook in most advanced economies. On the other hand, expansion of activities in emerging economies, though moderated in latest months, has been extensively contributing for the global growth.

In the United States, the economic growth decelerated in the fourth quarter of 2011/12 as measured by 1.5 percent annualized rate of growth of the real GDP compared to 2 percent growth in the preceding quarter. The decrease was on account of lower consumption growth, scaled down in government spending and negative net trade contribution. In the mean time, the contribution of inventories turned positive as non- residential and residential investment increased.

The growth of economic activities has been moderate in Japan, following strong GDP growth in the fourth quarter of 2011/12. Evidence shows that a weakening of sentiment in the manufacturing sector reflected in the industrial production which declined during the period under review related to weak exports owing to strong Japanese Yen and slowing of external demand for Japanese goods. Accordingly, the country registered the largest trade deficit in the second half of 2011/12 in its post-war history contributed by muted export growth and rising energy imports.

In the United Kingdom, real GDP declined by 0.7% in the fourth quarter of 2011/12 compared to the previous quarter as a result of decline in the construction and production industry. On the other hand, expansion in activity in the service sector has been observed, though confidence has turned down. Despite the improvement of the labor market situation, consumer confidence has also remained weak.

[1] Extracted from European Central Bank Monthly Bulletin November and October 2010.

In emerging markets, economic activities have continued to expand at a faster pace than advanced economies, although past policy tightening and weaker external demand reduced the growth momentum.

In China, economic activity has slowed down. According to the recent evidence available, real GDP growth declined to 7.6 percent annually in the fourth quarter of 2011/12, from 8.1 percent in the third quarter of the fiscal year. Quarter –on –quarter terms, however, growth accelerated slightly to 1.8 percent from 1.6 percent, driven by consumption and investment.

In the face of slowdown in global economic revival, the external sector of Ethiopia has continued in its pace of growth during the fourth quarter of the fiscal year. For instance, during the period under review, foreign exchange proceeds from export of merchandise surged by 13 and 19.9 percent compared to last year same period and the preceding quarter, respectively, as a result of enhanced volume of exports as well as improved international commodity prices.

In the mean time, earning from remittances has shown an annual increase of 11.1 percent while net service dropped by 32.3 percent. Likewise, the inflow of FDI declined by 30 percent in the same period.

On the other hand, total import bill for fuel grew by 17.8 and 1.3 percent vis-à-vis a year ago and the preceding quarter, respectively, following the increase in local demand for fuel which counterbalance the decline in international fuel price.

## 1.2 Macroeconomic Developments in Ethiopia

**Inflation**

During the fourth quarter of 2011/12 fiscal year, headline inflation surged to 6.7 percent from 5.2 percent in the previous quarter on account of 2.6 percentage point increase in food inflation which offset a 0.2 percentage decrease in non food (core) inflation.Food inflation grew to 7.7 percent from 5.1 percent in the previous quarter due to an increase in the CPI rate of most food items while non-food inflation rate decreased to 5.2 percent from 5.5 percent during the previous quarter. Food inflation contributed 4.8 percent to headline inflation of the reviewed quarter and non-food contributed 1.9 percent.

**Fuel price**

In the fourth quarter of 2011/12, average international price of crude oil was USD 92.92 per barrel, 9.8 percent down compared to the previous quarter. However, Addis Ababa average retail price of fuel remained at previous quarter level of Birr 17.8 per liter.

**Monetary Developments**

Money supply (M2), which is a measure of monetary aggregates in Ethiopia, reached Birr 189.4 billion at the close of the fourth quarter of 2011/12 revealing 10.4 and 30.3 percent quarterly and annual growth, respectively. Net foreign asset was Birr 39.8 billion at the end of the review quarter, indicating 28.4 and 13.1 percent slowdown on annual and quarterly basis, respectively. On the contrary, net domestic credit, showed 10.5 and 39.5 percent growth over the stock at end of March 2012 and June 2011 to reach Birr 189.1 billion. Therefore, the surge in broad money supply on quarterly and annual basis was due to an increase in net domestic credit, counterbalancing the slowdown in net foreign asset.

Reserve money reached Birr 65.97 billion at the end of the fourth quarter of the fiscal year 2011/12, depicting a year-on- year reduction of 4.5 percent, mainly due to the fall in banks' deposits at NBE. Excess reserves of commercial banks also declined significantly both on annual and quarterly basis due to commercial banks' participation on the weekly T- bills market. The money multiplier measured by the ratio of broad money to reserve money grew by 36.3 percent on annual terms implying the increased monetization of the economy.

**Interest rate**

Average saving deposit rate and average lending rates remained at 5.4 and 11.9 percent, respectively, on quarterly and annual basis. Weighted average time deposit rate, however, registered annual decline of 5.6 percent .On the other hand, the weighted average yield on T-bills increased from 1.067 to 1.621 percent over last year same quarter. Considering annual headline inflation of 20.9 percent during the quarter under review, all deposit rates, lending rates and T-bills yields remained negative in real terms.

Deposit rate was raised from 4.0 percent to 5.0 percent effective from 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.

**Financial Sector Developments**

Banks, insurance companies and microfinance institutions are the main financial institutions operating in Ethiopia. The number of banks reached 17 at the end of June 2012 of which 14 banks were privately owned.

During the review quarter, 108 new bank branches were opened, increasing the total number of bank branches to 1289. As a result, the ratio of total bank branch to total population decreased to 62,063 from 67,739 in the preceding quarter, reflecting an improvement in financial service outreach.

Similarly, the total number of insurance companies stood at 15 of which 14 were privately owned. The branches also increased to 243. Micro-finance institutions (MFIs) operating in the country remained at 31 during the quarter.

Meanwhile, the total capital of the banking system was Birr 18.0 billion at the end of the fourth quarter of the fiscal year 2011/12, of which private banks jointly accounted for 49.3 percent. Commercial Bank of Ethiopia, the giant state owned bank, accounted for 34.6 percent of the total capital of the banking system.

Total resources mobilized by the banking system (as measured by the sum of net change in deposit, loans collected and net change in borrowings) scaled down by 4.2 percent against the previous quarter on account of the decline in net deposit and net borrowing by 27.7 percent and 27.8 percent, respectively, offsetting the surge in loans collection by 57.6 percent. Year-on-year, total resources mobilized by the banking system scalded` up by 14.2 percent owing to arise in net deposit and loan collection by 13.1 percent and 34.4 percent, respectively counterbalancing the decline in net borrowing by 55.3 percent.

During the review quarter, total disbursement of new loans by the banking system was Birr 16.5 billion, reflecting a growth of 12.9 and 29.9 percent compared to the preceding quarter and the same quarter of last fiscal year, respectively. Public banks disbursed Birr 13.5 billion (or 82.1 percent) while the remaining balance was by the private banks. Over 99.4 percent of the new loan disbursement by the private banks went to finance private enterprise.

The banking system collected Birr 11.1 billion, about 34.4 percent higher than the same quarter last fiscal year. Of the total loan collection, public banks collected Birr 6.5 billion (58.6 percent) while private banks collected the remaining balance (about 41.4 percent). Of the total loan collection 57.4 percent was from cooperatives followed by the private enterprises (31.3 percent) and state enterprises (10.9 percent).

Total outstanding credit of the banking system (excluding interbank lending, credit to the government) increased to Birr 110.2 billion showing a 41.8 percent increase over against last year same quarter. Of the total outstanding loan, Birr 34.1 billion (or 43.7 percent) was a claim on the private enterprises while state enterprises and cooperatives accounted for 35.5 and 16.9 percent, respectively. Sector wise, credit to industry stood first with 30.5 percent share followed by international trade (22.7 percent), agriculture (15.6 percent), housing &construction (11.2 percent) and domestic trade (11.0 percent). The share of private banks in total outstanding loan stood at 32.0 percent.

Total deposits liabilities of the banking system reached Birr 187.3 billion at the end of the fourth quarter of the fiscal year 2011/12, indicating annual growth rate 33.3 percent. The growth in deposit mobilization was partially attributed to the expansion of bank branches' and improvements in economic activities.

Likewise, MFIs mobilized a total savings to the term of Birr 5.5 billion, which was 44.2 percent higher than last year same period.

**External Sector Developments**

Total export earnings in the fourth quarter of 2011/12 increased by 13 percent over last year same period, and amounted to USD 984.2 million. The annual increase in total export revenue was a result of higher earnings from export of coffee (9 percent), oilseeds (44.1 percent), gold (14.5 percent), pulses (66.7 percent), flower (10 percent), chat (3.8 percent), fruits & vegetables (17.9 percent) and live animals (2.9 percent).This was owing to enhanced volume of exports and/or improved international commodity prices.

Meanwhile, total merchandise import bill amounted to USD 2.8 billion, depicting 30.7 percent growth compared with the same period a year earlier. Increases in imports of capital goods (38 percent), consumer goods (14.9 percent), and semi-finished goods (58.4 percent and fuel (17.8 percent) were the major factors behind the annual average in imports.

Net receipts from services reached USD 68.8 million compared to the USD 95.4 million recorded a year ago. The decline in net service receipts was attributed to the decline in net travel (26.6 percent) and government services (27.8 percent).

The current account balance (including official transfers) registered deficit of USD 547.6 million in amount to USD 169.5 million surplus registered a year ago on account of the widening trade deficit, the rise in service payments and a significant reduction in official transfers.

**Foreign Exchange development**

During the review, the average exchange rate of the Birr in the inter-bank foreign exchange market stood at Birr 17.5503/US stringing a 1.4 percent depreciation vis-à-vis the preceding quarter and 4.4 percent against the same period last year. In the mean time,foreign exchange rate in the parallel market depreciated by 1.4 and 8.3 percent respectively to reach Birr 18.49/USD.

As a result, the spread between the official and parallel market rates widened to 5.35 percent from 1.51 percent last year same period, but slightly narrowed from 5.37 percent the preceding quarter.

## Federal Government Fiscal Operations

Total revenue and grant mobilized by the federal government was Birr 23.6billion. Year-on-year it scaled up by 20.6 percent. The quarterly performance was 26.3 percent of the annual plan .Total federal government expenditure (including regional transfers) reached Birr 29.9 billion, revealing annual and quarterly growth of 35.7 and 13.4 percent, respectively.

During the review quarter, the overall deficit (including grants) of Birr 6.3billion, higher than Birr 4.8billion deficit in the preceding quarter. It was financed by net external borrowing and net domestic borrowing.

## Investment

A total of 1,122 investment projects with an aggregate capital of Birr 13 billion were licensed by the Ethiopian Investment Agency and Regional Investment Offices during the fourth quarter of 2011/12. The number of approved investment projects showed a 7 percent quarter and 2 percent annual decline.