IX. INTERNATIONAL ECONOMIC DEVELOPMENT

7.1. Overview of the World Economy[2]

While the recovery of the world economy is continuing, the latest survey data suggest that growth has slowed in both advanced and emerging economies in recent months. Notwithstanding this rather synchronized growth moderation, the overall pace of expansion in emerging markets has remained solid in comparison with advanced economies. There are also indicators that Weak consumer and business confidence, fragile labor markets and ongoing balance sheet repair will continue to restrain the pace of growth in a number of advanced economies, while GDP growth in emerging economies, albeit decelerating, is expected to remain solid by comparison.

In the United States, real GDP accelerated in the third quarter of 2012. According to the advance estimate by the Bureau of Economic Analysis, real GDP increased at an annualized rate of 2.0% in the third quarter of 2012, up from 1.3% in the second quarter. The increase in the third quarter was mainly led by positive contributions from personal consumption expenditure (1.4 percentage points to real GDP growth) and by an upturn in government spending, this posted the strongest quarterly growth rate in three years, adding 0.7 percentage point to GDP growth. Economic activity in the third quarter also benefited from the acceleration in residential private investment, which added 0.3 percentage point to growth. On the other hand, net exports were a drag on growth (-0.2 percentage point), as the decline in exports was stronger than the one in imports, and non-residential investment and private inventories also subtracted from real GDP growth (-0.1 percentage point each).

In Japan, economic indicators continue to point to a deterioration of economic activity in the third quarter of 2012. On the domestic side, industrial production

[2] Sections 7.1 - 7.4 are excerpted from European Central Bank monthly bulletin for August, September and October 2012

declined by 1.3% and 4.1% in August & September, respectively and retail sales increased by a mere 0.4% in September. Real exports of goods declined for the fourth consecutive month in August (by 0.6%), while real imports declined by almost 4%. Fears of slowing world demand and adverse effects from the tensions between China and Japan were the major reasons for the decline in sentiment indicators in September. In the labor market, the unemployment rate remained fl at 4.2% in September. Weakness in the external environment was a further drag on economic activity. The trade balance decreased substantially in September and recorded the country's largest deficit to date.

In the United Kingdom, according to a preliminary estimate, real GDP increased by 1.0% quarter on quarter in the third quarter of 2012. There were broad-based gains in services and production, while construction continued to contract. The overall increase was largely driven by temporary factors, such as the London Olympics. However, there are also some signs that underlying growth is slowly moving into positive territory.

Economic conditions in China have improved in recent months. Real GDP growth decelerated slightly in year-on-year terms in the third quarter to 7.4% from 7.6%. However, this masks a solid rise on a seasonally-adjusted basis as the economy grew by 2.2% quarter on quarter, the strongest performance in four quarters, compared with 2.0% in the previous quarter. European Central Bank (ECB) estimates show that, growth in the third quarter was mainly supported by domestic demand, with consumption and investment contributing in almost equal measure, while net exports contributed only modestly. Growth in industrial production, fixed-asset investment and retail sales also accelerated in September. The housing market weakened slightly after a strong pick-up in August. Total export growth rebounded strongly in September to 10% in year-on-year terms. The increase in import growth was more subdued, but turned positive again following a decline in August.

7.2. Inflation Developments

Headline global inflation picked up slightly in August, mainly on the back of commodity price developments, while core inflation continued to ease. Similarly, global inflation picked up slightly again in September, largely driven by higher energy prices. In the OECD area, consumer price inflation rose to 2.2% in the year to September, from 2.1% in August. Excluding food and energy, the annual rate of inflation declined further to 1.6% in September, from 1.7% in August. In several emerging markets, annual rates of inflation also increased, but remain significantly below the peaks recorded last year.

In United States, annual CPI inflation increased from 1.4% in July to 1.7% in August, reaching its highest level since May 2012. The rise in headline inflation reflected mainly the rebound in energy prices in August, halting the downward trend. Annual food price inflation continued to ease further, standing at 2.0%, down from the peak of 4.7% in October 2011. Annual inflation, excluding food and energy, declined to 1.9%, from 2.1% in July.

In Japan, annual CPI inflation remained at -0.4% in August, and core CPI inflation (excluding food, beverages and energy) remained unchanged at -0.61%. On 19 September 2012 the Bank of Japan announced an amendment to its asset purchase program. The minimum bid yield for both Japanese government bonds and corporate bonds was removed. The increased purchases under the program will be completed by around the end of June 2013 for treasury discount bills and by around the end of 2013 for Japanese government bonds. The Bank of Japan kept its target interest rate unchanged at around 0% to 0.1%.

In United Kingdom, annual CPI inflation slowed down to 2.5% in August from 2.6% in July, while CPI inflation excluding energy and unprocessed food decreased to 2.2% from 2.4%. Looking ahead, the existence of spare capacity and the sluggish recovery in economic activity should help contain inflationary pressures.

In China, annual CPI inflation increased to 2.0% in August, from 1.8% in the previous month, remaining well below the government's 4% target for 2012. Renminbi-denominated loans and broad money continued to grow robustly.

7.3. Commodity Price

The Oil prices that declined by 1.5% in September is partly reversing its increment that began in July. Brent crude oil prices stood at USD 112 per barrel on 2 October, implying an increase of 24% with respect to their lowest level recorded in 2012 on 26 June, but still 11% below the 2012 peak reached on 14 March. Looking ahead, market participants expect lower oil prices over the medium term, with futures contracts for December 2013 trading at USD 105 per barrel.

The recent decline in oil prices reflects a combination of supply and demand factors. On the supply side, Saudi Arabia announced an increase in oil supply in response to the losses in production following the oil sanctions against Iran in particular. This announcement partially offset the upward pressure on oil prices caused by a fall in oil supply in both OPEC and non-OPEC countries in the previous months. Market reports on a potential strategic oil inventory release by industrialized countries also contributed to lower oil prices. On the demand side, although oil demand is generally expected to grow at a steady pace in 2013, the International Energy Agency revised its expectations on oil demand growth slightly downwards on account of slowing global economic activity.

Prices of non-energy commodities increased again in September, after slight declines in August. The increase was mainly driven by higher prices for metals and iron ore. Agricultural commodity prices continued their decline after the spikes of June and July caused by droughts in the United States. In aggregate terms, the price index for non-energy commodities (denominated in US dollars) stood 3.0% higher towards the end of September than at the beginning of the year.

7.4. Exchange Rate Developments

Between the end of June and early October 2012 the effective exchange rate of the euro remained broadly unchanged in an environment of declining volatility. The continued depreciation of the effective exchange rate of the euro throughout July started to reverse in mid-August and on 2 October 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, stood 0.4% above its level at the end of June 2012 and 5.6% below its average level in 2011.

In bilateral terms, over the past three months the euro has appreciated against most major currencies. Between 29 June and 2 October 2012 the euro appreciated against the US dollar (by 2.7%), the Japanese yen (by 0.9%) and the Swiss franc (by 0.6%), but depreciated against the pound sterling (by 0.8%). Over the same horizon, the euro also depreciated vis-à-vis some other European currencies, including the Polish zloty (by 3.4%), the Czech koruna (by 2.3%) and the Hungarian forint (by 0.8%). Market volatility, as measured on the basis of foreign exchange option prices, has decreased overall over the past three months and remains below historical averages.

7.5. Impact of Global Economic Development on Ethiopian Economy

Despite recovery in the global economy, export earnings during first quarter of 2012/13 fell by 29.1 and 7.3 percent on quarterly and quarter-on quarter bases, respectively. Decline in the international price of major export items contributed to this decline although some other domestic factors also played a role.

However, following the recovery in the global economy, the receipts from private transfers rose by 25.7 and 5.4 percent during the first quarter of 2012/13 vis-à-vis last year same period and the preceding quarter, respectively. FDI also surged by 66.3 percent in relation to last year the same period.

Similarly, the quarter-on-quarter downward movement in international oil price, which is associated with improved oil supply, could not lead to a decline in Ethiopian fuel import bill (19.4 percent share which used to be 19.2 percent last year the same period) due to increased fuel demand of the country. Consequently, balance of payments deficit widened in relation to the preceding quarter and the same period last year.