I. OVERVIEW

I.1. International Economic Development

Overview of the World Economy

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.

In the United States, real GDP accelerated in the third quarter of 2012 as measured by 2 percent, at an annualized rate, up from 1.3 percent in the previous quarter. The increase in the third quarter was mainly led by positive contributions from personal consumption expenditure and the acceleration in residential private investment.

On the other hand, net exports and non-residential investment and private inventories were a drag on growth.

In Japan, economic indicators continue to point to a deterioration of economic activity in the third quarter of 2012. On the domestic side, declining of industrial production, slowdown in real import and export of goods contributed for the deterioration of the growth in the reviewed quarter. 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 percent 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

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

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 percent from 7.6 percent. However, this masks a solid rise on a seasonally-adjusted basis as the economy grew by 2.2 percent quarter on quarter, the strongest performance in four quarters, compared with 2 percent 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.

Despite recovery in the global economy, Ethiopian 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.

I.2. Macroeconomic Developments in Ethiopia

Inflation

Headline CPI inflation in the first quarter of 2012/13 stood at 1.9 percent down by 4.7 percentage point from 6.6 registered in same period last year. While food inflation declined sharply to 0.9 percent from 8.8 percent, non food inflation increased slightly to 3.3 percent from 3.4 percent compared to same period last year. Likewise, the headline inflation went down by 4.8 percentage point relative to 6.7 percent registered in the preceding quarter as food inflation rate dropped significantly by 6.7 percentage point to 0.9 percent while non food inflation rate went down by 1.8 percentage point to 3.4 percent. In the reviewed quarter, non food inflation contributed 1.3 percent to the headline inflation while food inflation constituted the remaining 0.6 percent.

Fuel prices

The price of crude oil in international market continued to decline during the review period and reached USD 92.69 per barrel from USD 93.73 per barrel registered in the previous quarter.

Following the marginal downward movements of the global fuel price, the government made adjustments on domestic fuel price.

Accordingly the average retail prices of fuel in Addis Ababa during the review period stood at Birr 17 per liter, depicting 4.2 and 4.5 percent reduction annually and quarter-to-quarter basis respectively.

Monetary Developments

Broad money supply (M2), a measure of monetary aggregate, reached Birr 192.1 billion at the close of the first quarter of 2012/13 reflecting 1.4 percent quarterly and 27.4 annual growth. Net foreign asset was Birr 39.3 billion indicating 29.2 percent annual and 1.2 percent quarterly slowdown. On the contrary, net domestic credit, another determinant of broad money supply, declined by 2.2 percent compared to June 2012 balance. Therefore, the surge in broad money supply on quarterly and annual basis was due to an increase in net domestic credit, offsetting the declined in net foreign asset.

Reserve money reached Birr 66.3 billion at the end of the first quarter of the fiscal year 2012/13, revealing a 2.7 percent annual decline mainly due to the fall in banks' deposits at NBE. Excess reserves of commercial banks also declined considerably on both annual and quarterly basis due to their active participation in the weekly T- bills market.

The money multiplier measured by the ratio of broad money to reserve money, surged by 30.9 percent on annual terms implying improvement in monetization of the economy. Similarly, the ratio of narrow money to reserve money is increased by 21.6 percent.

Interest rate

Average saving deposit and lending rates remained at 5.4 and 11.9 percent on quarterly and annual basis respectively. Weighted average time deposit rate, however, registered annual increase of 7.6 percent. Weighted average yield on T-bills also increased from 1.604 percent to 2.43 percent. Yet, considering annual headline inflation of 18.9 percent during the quarter under review, all deposit rates, lending rates and yields remained negative in real terms.

Financial Sector Developments

Banks, insurance companies and microfinance institutions are the major financial institutions in Ethiopia. The number of banks operating in the country reached 18 at the end of September 2012 of which 15 banks were privately owned.

During the review quarter, 87 new bank branches were opened, increasing the total number of bank branches to 1,376. As a result, the ratio of total bank branch to total population went down to 58,139.5 revealing improvement in financial service outreach.

Similarly, the total number of insurance companies operating in the country also reached 15 of which 14 were privately owned. The number of branches increased to 252 from 227 compared to the same period last year. Of the total branches, about 54.4 percent were located in Addis Ababa. On the other hand, there were 31 micro-finance institutions (MFIs) operating in the country.

The total capital of the banking system reached Birr 20.2 billion at the end of the first quarter of which private banks altogether took 46.9 percent share. Commercial Bank of Ethiopia alone accounted for 37.5 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) slowed down by 35.8 percent over the preceding quarter due to the decline in net deposit and loan collection. Likewise, year-on-year basis, total resources mobilized by the banking system decreased by 15.5 percent owing to the decline in net deposit and net borrowing.

Total disbursement of fresh loans by the banking system reached Birr 9.9 billion, showing 14.6 percent slowdown compared to last fiscal year. Public banks disbursed Birr 5.5 billion or 55.3 percent of the total fresh loan.

Sector wise, industry was the largest beneficiary (29.9 percent), followed by agriculture (24.9 percent), domestic trade (15.3 percent), international trade (13.4 percent) and housing and construction (10.9 percent).

During the review period, the banking system collected Birr 10.6 billion, about 8.1 percent higher than a year ago. Of the total loan collection, private banks collected Birr 4.2 billion or 40.0 percent while public banks collected the remaining balance (about 60.0 percent). Of the total loan collection 52.5 percent was from cooperatives followed by private enterprises (26.2 percent) and state enterprises (20.8 percent).

Total outstanding credit of the banking system (excluding credit to government) increased to Birr 110.6 billion at the end of September 2012, up by 30.7 percent against last year.

About 98.7 percent of outstanding loan of private banks was a claim on private enterprises. The growth in deposit mobilization was partly attributed to the rise in the number of bank branches and improvements in economic activities.

Similarly, outstanding credit of the MFIs scaled up by 37.5 percent on annual basis to reach Birr 9.8 billion.

External Sector and Foreign Exchange Developments

Total merchandise exports at USD 698.1 million declined by 7.3 percent annual terms. This was attributed to lower export earnings from oilseeds (26.8 percent), live animals (29 percent), flower (15.4 percent), leather & leather products (20 percent), meat & meat

The service account recorded USD 140.6 million net receipts, up by 30.7 and 117.6 percent vis-à-vis last year same period and the preceding quarter, respectively. The quarter-on-quarter increase in net service receipts was solely attributed to the rise in net transport services (16.4 percent) despite remarkable fall in net travel (27.7 percent), net government (27.8 percent) and net other service payments (38.1 percent).

products (13.3 percent), coffee (1.3 percent, gold (1.8 percent) and fruits & vegetables (5.3 percent).

Despite an increase in the volume of export (31.7 percent), receipts from export of coffee stood at USD 199.3 million, recording 1.3 percent decline compared to the same quarter a year ago as the international price of coffee fell by 25.1 percent.

Total merchandise import during the first quarter of 2012/13 scaled up by 17.9 percent on annual basis to USD 2.72 billion due to an increase in imports of capital goods (46.1 percent), semi-finished goods (27 percent), and fuel (19.3percent).

Similarly, the quarterly rise in net service receipts was mainly due to higher receipts from transport (90.5 percent) and travel (2.3 percent) that outweighs the fall in net government (22.8 percent) and other services payments (13.1 percent).

The current account balance (including official transfers) registered 614 million in deficit during the first quarter of

2012/13, much higher than USD 131.4 million deficit recorded last year same period because of the widening trade deficit out weighting the rise in net services and private transfers.

The average official exchange rate of the Birr in the inter-bank foreign exchange market stood at Birr 17.87/USD depicting 1.8 percent depreciation against last year same quarter.

Average exchange rate of the Birr in the parallel foreign exchange market also was depreciated by 6 percent year-on-year to reach Birr 18.44/USD.

Consequently, the premium between the two market rates narrowed to 3.2 percent from 5.4 percent in the previous quarter, but widened from 2.3 percent the same quarter a year earlier.

Federal Government Fiscal Operations

Total federal government revenue and grants reached Birr 27.2 billion during the first quarter of 2012/13 registering 30.7 percent annual growth. The total quarterly revenue and grants accounted for 26.3 percent of the annual plan.

On the other hand, total federal government expenditure in the same rose by 8.6 percent to reach Birr 21.5 billion with respect to the same period last year.

Accordingly, the overall fiscal balance (including grants) showed a Birr 5.7 billion surplus compared to Birr 1.0 billion surplus recorded a year ago.

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 2 percent decrease compared to last fiscal year.

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