I. OVERVIEW

1.1 International Economic Developments

During the review quarter, the global economic recovery is progressing at a gradual pace, underpinned by strengthening growth momentum in most developed economies. At the same time, following the Federal Open Market Committee's (FOMC) decision in December 2013 to "taper" its asset-purchasing program, uncertainty in global financial markets have turned down. This may further support global economic activities. Global trade sustained momentum at the start of the review quarter, witnessing further signs of stabilization after a protracted period of subdued growth. Yet the pace of recovery in global trade growth is likely to be modest in the near term and remain below the levels observed prior to the financial crisis.

In the United States, real GDP growth remained strong in the fourth quarter of 2013. According to the first estimate by the Bureau of Economic Analysis, real GDP grew at annualized rate of 3.2 percent (0.8 percent quarter on quarter), down from 4.1 percent (1.0 percent quarter on quarter) in the previous quarter. Growth was supported by stronger gains in personal consumption expenditure and exports than in the previous quarter, while inventory building contributed to growth for the fourth consecutive quarter. Residential investment and public spending both declined the latter as a result of a decline in federal spending that more than offset an increase in state and local government spending. Moreover, the strength of the contributions to GDP growth from inventories over the past four quarters suggests that there could be a payback in the first quarter. Regarding the labor market, the pace of job creation has slowed in the final month of 2013, somewhat as a result of the unusually cold weather. Meanwhile, the unemployment rate turned down further in December, with more workers dropping out of the labor force. Overall, survey indicators are consistent with a continued gradual upturn in the labor market.

In Japan, strong sentiment data suggest a surge in growth during the fourth quarter of 2013. The Bank of Japan's Tankan Survey indicated increases in business confidence during the fourth quarter for large, medium and small enterprises. Meanwhile, industrial output grew by 1.9 percent in the review quarter vis-a-vis the third quarter.

The United Kingdom has experienced robust economic growth in the fourth quarter of 2013, a real GDP growth of 0.7 percent (quarter on quarter), driven mainly by the services sector. Despite slight turn down in some of the main business and household survey indicators in recent months, the relatively high level of most of the indicators suggests that growth remained strong in UK. In the medium term, however, the pace of growth is likely to downturn somewhat. The relatively weak household real income dynamics and the ongoing need for private and public sector balance sheet adjustment will continue to constrain domestic demand for some time, while prospects for export growth remain subdued. However, the labor market situation has continued to improve strongly, with full-time private sector employment growth in particular picking up in recent months.

In China, economic growth decelerated slightly in the fourth quarter of 2013 (as the effects of a small stimulus package implemented over the summer waned) but remained strong overall. GDP grew by 7.7 percent year on year (1.8 percent quarter on quarter), broadly in line with market expectations and down from 7.8 percent (2.2 percent) in the third quarter. In 2013 as a whole, GDP growth was 7.7 percent, slightly above the government's target of 7.5 percent. The decline in momentum in the fourth quarter was also observed in industrial production and fixed investment, which recorded lower growth. Monetary and credit aggregates also grew more slowly in December in line with the People's Bank of China's intention to gradually lower the leverage of the economy, but continued to expand more rapidly than nominal GDP growth.

During the second quarter, the global economic activity has gradually recovered that could in turn influence the external sector of Ethiopia. Net receipt from export of services improved by 145.2 percent vis-à-vis last year same quarter. FDI also registered a turn-up of 173.6 percent in comparison to last year same quarter. However, despite the gradual recovery of the global economy, both net private and public transfers have declined by 17 and 93.2 percent, respectively, vis-à-vis last year same quarter. In addition, export has not yet responded to the recovery of the global economic activity. Compared to last year same period, merchandise exports have scaled down by 4.9 percent. A slowdown in the prices of major export commodities of the country in the international market and decline in the production of some of the export commodities have contributed to this effect. On the other hand, imports have picked-up by 13.3 percent compared to last year same quarter largely driven by cereal imports and higher fuel import bill due to increased fuel demand of the country. Consequently, balance of the payments deficit widened compared to last fiscal year same period.

1.2 Macroeconomic Developments in Ethiopia

Fuel prices

During the second quarter of the fiscal year 2013/14, the average price of crude oil was USD 109.4 per barrel; scaling down slightly against the USD 110.4 and USD 110.1 per barrel registered in the previous year same quarter and the preceding quarter, respectively.

In the review quarter, the average retail price of fuel in Addis Ababa increased to Birr 17.62 per liter depicting an average increase of 4.0 and 4.7 percent vis-à-vis the same quarter of last year and the preceding quarter, respectively. Accordingly, the average retail prices of petroleum products in Addis Ababa were revised down by 4.6 percent vis-à-vis the same quarter of last year while it remained unchanged at Birr 16.8 per liter compared with the preceding quarter.

Inflation

During the second quarter of the fiscal year 2013/14, headline inflation dropped to 1.3 percent from 4.1 percent in the previous quarter, although it slightly rose by 0.5 percentage point against last year same quarter. The quarterly slowdown was on account of 4.4 percentage point downturn in food & non-alcoholic beverages inflation and 1.1 percentage point decline in non-food inflation.

Quarterly food & non-alcoholic beverage inflation decelerated to 0.3 percent in contrast to 4.7 percent during the previous quarter. Similarly, non-food inflation scaled down to 2.3

percent from 3.4 percent in the preceding quarter. During the review quarter, non-food inflation contributed 1.1 percent to the quarterly headline inflation while food & non-alcoholic beverage contributed the remaining 0.2 percent.

Monetary Developments

At the end of the second quarter of the fiscal year 2013/14, domestic liquidity measured by broad money supply (M_2), reached Birr 252.4 billion, revealing annual and quarterly growth of 22.3 and 6.4 percent, respectively. The growth in broad money was exclusively driven by a 30.6 percent surge in domestic credit counter-balancing a 15.6 percent decline in net foreign asset. Year-on-year, domestic credit grew by 30.6 percent driven by 51.7 percent surge in credit to government and 29.2 percent growth to non-government sectors.

Reserve money reached Birr 72.3 billion at the end of the second quarter of 2013/14, depicting an annual slowdown of 3.7 percent although it registered a quarterly increase of 1.3 percent.

Excess reserves of commercial banks increased remarkably by 63.2 percent year-on-year but recorded a 31.3 percent quarterly slowdown. The annual growth in excess reserves was predominantly due to the reduction of reserve requirement to 5 percent from 10 percent effective March 1, 2013.

Interest rate

Average savings deposit and lending rates remained unchanged at 5.4 percent and 11.88 percent, respectively. Weighted average time deposit rate, however, registered annual increase of 5.2 percentage point. Weighted average yield on T-bills also slightly rose from 1.53 percent to 1.93 percent on annual basis. Considering annual headline inflation of 7.7 percent in the quarter under review, all deposit rates and the T-bill yield adjusted for inflation remained negative while average lending rate was positive in real terms.

Financial Sector Developments

Banks, insurance companies and microfinance institutions are the main formal financial institutions operating in Ethiopia. The number of banks in the country was 19 as at the end of December 2013, of which 16 banks were private owned. About, 183 new bank branches were opened during the review quarter, taking the total number of bank branches to 2,015. Consequently, the ratio of total bank branch to total population went down to 42,977.7 from 49,768.5 in the preceding quarter, revealing a considerable progress in financial service outreach.

Addis Ababa had 33 percent share in total bank branches. The share of private banks increased marginally to 52.5 percent from 50.1 percent in the preceding quarter due to the opening of 140 new branches by private banks exceeding the 43 new branches opened by the public banks during the review quarter.

Meanwhile, the total capital of the banking system scaled up by 3.3 percent compared to the preceding quarter and reached Birr 25 billion, of which private banks together accounted for 53 percent and public banks 47 percent. Commercial Bank of Ethiopia, the state owned bank, alone mobilized 36.2 percent of the total capital of the banking system while the remaining 10.8 percent went to Development Bank of Ethiopia and Construction & Business Bank, the other two state owned banks.

The total number of insurance companies remained at 17 during the review quarter, of which 16 were privately owned. Their branch network, however, increased to 293 from 284 in the preceding quarter. About 55.3 percent of the total insurance branches are located in Addis Ababa witnessing a noticeable concentration of insurance services in the capital. Insurance industry recorded a 4.2 percent modest increase in capital accumulation which stood at Birr 1.7 billion at the close of the review quarter. The capital share of the private insurance companies has reached 77.4 percent.

During the review quarter, there were 31 micro-finance institutions (MFIs) operating in the country. These MFIs mobilized a total saving deposit of Birr 8.7 billion, about 45.2 percent higher than the last year same quarter. Similarly, outstanding credit of MFIs increased by 33.5 percent during the same period and reached Birr 13.7 billion. Likewise, their total assets picked-up 38.6 percent to Birr 20.4 billion by the end of the review quarter.

Total resources mobilized by the banking system, the sum of net change in deposit, loan collection and net change in borrowings, grew by 145.3 percent vis-à-vis the preceding quarter. Similarly, quarter-on-quarter basis, total resources mobilized by the banking system increased by 11.2 percent.

During the review quarter, total disbursement of fresh loans by the banking system reached Birr 16.8 billion, revealing a surge of 18.9 percent and 75.4 percent vis-à-vis the preceding quarter and last year same quarter, respectively. Public banks disbursed Birr 11.5 billion (68.7 percent) with private banks taking the remaining balance.

The banking system collected Birr 10.4 billion loans formerly disbursed, which was 8.8 percent higher than last year same period. Of the total loan collected, Birr 5.9 billion (57.2 percent) was by private banks and Birr 4.5 billion (42.8 percent) by public banks. Of the total loan collected, 77 percent was from private enterprises followed by cooperatives (13.9 percent) and state enterprises (9.1 percent).

Total outstanding credit of the banking system (including credit to government) reached Birr 164.4 billion at the end of December 2013, up by 10.3 percent against the preceding quarter.

About 95.4 percent of outstanding loan of the private banks was claim on private enterprises, 3.3 percent on the central government and (1.2 percent) on cooperatives On the other hand, 41.9 percent, of the total public banks' outstanding loan was claim on state enterprises , 39 percent on private enterprises, 10.1 percent on central government and (9 percent) on cooperatives.

1.3 External Sector and Foreign Exchange Developments

Total earnings from merchandise exports scaled down by 4.9 percent quarter-on- quarter but increased by 7.9 percent on quarterly basis, and amounted to USD 681.2 million. The quarter-on-quarter decline was on account of the slowdown in the export earnings from coffee (47.3 percent), gold (12.9 percent), flower (0.1 percent), live-animal (5.4 percent) and meat & meat products (7.3 percent) due to a decline in export volume, prices or both.

The unit value of coffee dropped by 8.6 and 1.0 percent on quarter-on-quarter and quarterly basis, respectively. As a result of the current dismal global coffee market condition, the volume of coffee export in the review quarter decelerated by 37.3 and 42.4 percent vis-à-vis the previous quarter and same quarter last year, respectively. Meanwhile, the value of export of coffee scaled down to USD 85.3 million from USD 161.9 million in the same quarter of last fiscal year. The share of coffee export proceeds in total export earnings declined to 12.5 percent from 22.6 percent a year ago and 21.8 percent in the preceding quarter.

Total merchandise import bill during the second quarter of 2013/14 was USD 3.5 billion, which went up by19.6 percent against the previous quarter on account of higher imports of consumer goods (29.1 percent), capital goods (37.4 percent) and semi-finished goods (25.3 percent). The surge in imports of capital goods was attributed to the increase in import value of industrial (52.2 percent) and transport goods (21.0 percent). Likewise, payment for fertilizer scaled up by 24.6 percent year-on-year basis. With respect to last year same quarter, total import surged by 13.3 percent largely due to an increase in import of consumer goods (28.2 percent), capital goods (8.2 percent) fuel (5.4 percent) and semi-finished goods (5.6 percent). The rise in import value of consumer goods was attributed to a rise in import of non- durable consumer goods (32.0 percent) and durable consumer goods (20.5 percent)**.** On the other hand, import of raw materials decelerated by 0.3 percent.The net receipt from service export stood at USD 152.3 million, up from USD 62.1 million last year same period. This was attributed to the rise in net transport services (7.7 percent) and government services (108 percent).

In the review quarter, total net transfer receipts scaled down by 44.1 percent compared to last year same quarter to USD 1.1 billion as net official and private transfers decreased by 93.2

and 17 percent, respectively. The slowdown in net private transfers to USD 1 billion was on account of the 65.6 percent drop in NGO transfer which offset the 34.2 percent surge in cash remittances from private individuals.

The current account balance (including official transfers) registered a deficit of USD 1.6 billion during the second quarter of 2013/14, about five times higher than USD 323.2 million deficits registered a year earlier. The worsening current account deficit was attributed to the slowdown in net private transfers (17 percent), official transfers (93.2 percent) and higher trade deficit (18.8 percent).

In the review quarter, the capital account recorded a surplus of USD 1.4 billion about 28.8 percent higher than last year same quarter. This was due to the rise in inflows of foreign direct investment (173.6 percent) and short-term capital (648.8 percent).

During the second quarter of 2013/14, the average official exchange rate of the Birr depreciated by 4.8 percent and 1.1 percent compared to last year same quarter and the preceding quarter, respectively, to reach Birr 18.9390/USD. Similarly, in the parallel market, average exchange rate depreciated by 4.3 percent relative to same quarter a year earlier while it has appreciated by 1.1 percent over the preceding quarter to reach Birr 19.5415/USD.

As a result of relatively faster rate of depreciation of the Birr in the official market, the premium between the two market rates narrowed to 3.2 percent from 3.6 percent in same quarter last year and 5.5 percent in the previous quarter.

1.2 Federal Government Fiscal Operations

During the second quarter of 2013/14, total revenues and grants mobilized by the federal government amounted to Birr 32.8 billion, about 16 percent higher than last year same quarter.

Government expenditure (including regional transfers) during the review quarter was Birr 34 billion, showing a 21.6 percent annual growth of the total expenditure, current expenditure amounted to Birr 7.3 billion (21.7 percent) , capital expenditure Birr 11.2 billion (33.1 percent) and regional transfers Birr 15.4 billion (45.2 percent).

The overall Federal government budget deficit was Birr 1.2 billion, considerably wider compared to a surplus of Birr 292 million a year ago.

INVESTMENT

The Ethiopian Investment Agency and regional investment Offices issued investment licenses to about 1,735 projects with a total capital of Birr 21.5 billion during the first quarter of 2013/14.