

VIII. International Economic Development

8.1 Overview of the World Economy¹

Global economy continues to grow at a modest pace, with the recovery slowly gaining some traction, although it remains diverse across economic regions and continue to be fragile. Having stabilized at low levels in the third quarter of 2012, consumer and business sentiment showed improvement in the final quarter of 2012 despite a number of indices remain below their long-term averages, and activity is expected to strengthen only gradually. Outside of the euro area, indicators of consumer confidence rose in a number of advanced and emerging economies. Global inflation eased in November, as energy prices resumed their downward trend following a temporary acceleration in the previous months.

In the United States, GDP growth slowed down markedly in the fourth quarter as global uncertainty and tight government spending dampened economic activity.

According to the estimate by the Bureau of Economic Analysis, real GDP increased by an annualized 0.1% in the fourth quarter of 2012, down from 3.1% in the third quarter. This slowdown was mainly due to temporary factors.

Government spending supported growth in the third quarter, but then fell abruptly in the fourth quarter, mainly owing to lower national defense spending, while private inventories also posted a sharp reversal. Imports declined more than exports, with net exports overall contributing positively to growth. Meanwhile, private domestic demand held up relatively well and gained momentum. Fixed investment accelerated sharply in both the residential and non-residential sectors, and personal consumption expenditure growth also accelerated. These positive developments came amidst substantial uncertainty surrounding the health of the global economy and also despite the threat of fiscal tightening ahead of the fiscal cliff.

In Japan, in a weak economic environment, high-frequency indicators were positive towards the end of 2012. Industrial

¹Sections 8.1 - 8.4 are excerpted from European Central Bank monthly bulletin of December 2012 and January & February 2013.

production bottomed out, partly driven by the yen's weakness and stronger private consumption. The positive impact of private consumption on the economy was also reflected in the improvement of retail sales over the course of the final quarter. During the final months of 2012, the trade deficit stood at a record high, driven by a strong yen earlier in the year and weak external demand, which was amplified by the Sino-Japanese tensions in the second half of 2012. The trade deficit improved slightly in December 2012, as exports softened to a lesser extent than imports. More timely business sentiment indicators, such as the PMI composite output index for January, support the view that growth is likely to recover gradually during 2013.

In the United Kingdom, the recovery of economic activity is likely to progress very gradually over the course of the year, as domestic demand continues to be constrained by still tight credit conditions, ongoing household balance sheet adjustment and substantial fiscal tightening, while the contribution of exports to growth will be limited. In the fourth quarter of 2012, real GDP declined by 0.3% quarter on quarter, according to the preliminary estimate. This decline was due to a drop in industrial sector

activity, while services output remained unchanged. Despite the weak economic conditions, the labor market situation has continued to improve gradually, with the unemployment rate declining to 7.7% in the three months to November 2012. Credit growth remains frail, but some surveys have pointed to an improvement in credit conditions recently.

In China, GDP figures relating to the fourth quarter of 2012 confirmed that an upswing in growth was underway. In year-on-year terms, growth accelerated to 7.9% at the end of 2012, from 7.4% in the third quarter. While no official quarter-on-quarter contributions to GDP growth are published, it is likely that consumption and investment were the main contributors to growth. Growth momentum seemed to spill over into 2013, with the January manufacturing PMI reaching a two-year high. Looking ahead, the economy is expected to continue growing strongly in 2013 amid a gradually improving external environment.

In Middle East and Africa in the third quarter of 2012 oil production was maintained at high levels and government spending supported by high oil prices boosted output in the oil-exporting economies of the Middle East and Africa. In

the same period, elsewhere in the region, growth slowed somewhat in year-on-year terms compared with the first half of 2012. Economic activity remained weak in those countries in which the political transition process has been stained by delays. Growth in the oil-exporting countries is expected to moderate in the near term on account of lower oil output, whereas continued robust growth is projected for the rest of the region.

8.2 Inflation Developments

In advanced countries inflation stabilized in the final months of 2012. In the OECD area, annual headline consumer price inflation remained unchanged at 1.9% in December.

The stabilization in inflation was rather broadly based across OECD countries. Excluding food and energy, inflation decreased slightly to 1.5% in December, after holding steady at 1.6% in the previous four months. Meanwhile, annual inflation increased significantly in a number of emerging economies, most notably in China and Brazil.

In United States, annual CPI inflation declined to 1.7% during December 2012, down from 1.8% in November 2012 and

Economic activity in Latin America strengthened towards the end of 2012, after experiencing a slowdown for most of the year. For 2012 as a whole, annual real GDP growth in the region is likely to have stayed near to 3%, down from 4.5% recorded in 2011, reflecting lower external demand and weaker domestic demand.

lower than the 3.0% recorded in December 2011. This lower rate of inflation was due to weak growth in energy prices while food inflation remained unchanged. Excluding food and energy, annual CPI inflation remained unchanged at 1.9%.

In Japan, the economy remains in deflationary territory. Annual CPI inflation increased slightly to -0.1% in December from -0.2% in November, which marks the seven consecutive month of deflation. At its latest monetary policy meeting on 20 December 2012, the Bank of Japan decided to maintain its target for the uncollateralized overnight call rate within a range of 0.0% to 0.1%. Moreover, the Bank of Japan expanded its Asset Purchase Program by JPY 10 trillion, split between an increase of

JPY 5 trillion on purchases of Treasury discount bills and JPY 5 trillion on purchases of Japanese government bonds.

In United Kingdom, annual CPI inflation has been relatively stable in the final months of 2012. It remained unchanged at 2.7% in December 2012 for the third consecutive month. Meanwhile, CPI inflation excluding energy and unprocessed food declined was by 0.2 percentage point to 2.6% in December. Looking ahead, weak wage growth, the existence of ample spare capacity and the sluggish recovery in economic activity should contribute to a dampening of inflationary pressures in the medium term.

In China, price pressures increased in December as annual CPI inflation rose to 2.5%, driven to a very large extent by a spike in food prices. PPI inflation also rose, but remained negative for the tenth month in a row. PPI inflation also rose, but remained negative for the tenth month in a row. Financial and monetary indicators continued to increase, in particular owing to high growth in non-bank lending. Both exports and imports, including to and from the euro area, rebounded towards the end of the year, resulting in the highest 12-month cumulative

trade balance since October 2009, reaching USD 232.8 billion.

In Middle East and Africa, consumer price inflation has continued to decline in most countries through the third quarter of 2012. However, it increased by 3.3%, year on year, in the third quarter, compared with an average of 4.6% for the second quarter of 2012.

In Latin America, after having eased in the first half of 2012 on the back of lower commodity and food prices and a moderation in growth, inflation picked up again in the third quarter due to higher food and agricultural prices. In Brazil after inflation had eased in the first half of 2012, mainly reflecting lower commodity prices and a moderation in growth, price pressures increased again primarily as a result of the rise in agricultural prices. Consumer price inflation posted a year-on-year growth rate of 5.2% in the third quarter of 2012, compared with 5.0% in the second quarter.

Strong food price increases in Mexico have put upward pressure on inflation, with consumer price inflation rising to 4.6% in the third quarter, from 3.9% in the second quarter. Argentina's annual inflation

remained unchanged in the third quarter of 2012 at 10%.

8.3 Commodity markets

Oil prices have been trading in a range of USD 106-116 per barrel since early October, after recovering during the third quarter of 2012 from lows reached in June 2012. Brent crude oil prices continued to trade in the range between USD 107-112 per barrel in December 2012. The current oil prices are close to levels seen a year ago. Global oil demand is projected to remain sluggish in 2013, while it has been revised upwards for the last quarter of 2012. On the supply side, geopolitical tensions in the Middle East persist. This notwithstanding, global oil supply increased further recently, primarily in non-OPEC countries but also in OPEC countries. Looking forward, market participants expect slightly lower prices over the medium-term, with December 2013 futures prices trading at USD 106 per barrel. Prices of non-energy commodities decreased in October and November, eliminating the increases observed in the third quarter of 2012. Agricultural commodity prices continued their declines, driven by more favorable supply conditions, thereby offsetting most of the increases in June and

July owing to the droughts in the United States. Metal prices have posted overall a slight decline since the beginning of October, amid some volatility caused by increased uncertainty about global growth. In aggregate terms, the price index for non-energy commodities (denominated in US dollars) stood 0.7% higher at the end of November than at the beginning of the year. In December, prices of non-energy commodities were broadly unchanged, on aggregate, with increases in most metal prices offsetting broad-based declines in food prices. The increase in the price of most metals, which was especially large in iron-ore, was driven largely by a more positive market sentiment regarding demand from China, while generally accommodative supply conditions put downward pressure on all food price components. In aggregate terms, the price index for non-energy commodities (denominated in US dollars) was about 1.5% higher at the end of December 2012 compared with the same period a year earlier.

8.4 Exchange Rate Developments

The euro has broadly appreciated against most major currencies since early September 2012. On 5 December 2012, the exchange rate of the euro expressed in nominal effective terms, as measured against the currencies of 20 of the euro area's most important trading partners stood 2.2% above its level at the end of August, and 4.9% below its average level in 2011. Movements in the euro exchange rate over the past three months continued to be largely related to changing market sentiment regarding the fiscal and economic prospects for some euro area countries, as well as developments in expected yield differentials between the euro area and other advanced economies. At the same time, market volatility as measured on the basis of the implied volatility of foreign exchange option prices continued to remain below historical averages.

With regard to indicators of the international price and cost competitiveness of the euro area, in November 2012 the real effective exchange rate of the euro based on consumer prices (as measured against the currencies of 20 of the euro area's most important trading partners) was 5.8% below its average level for 2011. This mostly

reflected the nominal depreciation of the euro since 2011.

Bilaterally, the euro has appreciated against the US dollar. From 31 August to 5 December 2012, the euro strengthened by 3.6% vis-à-vis the US dollar, but remained 6.1% below its 2011 average. The main factor driving the USD/EUR exchange rate was market uncertainty and movements in yield differentials between the two economies. Over the period under review, the euro also appreciated against the Japanese yen. On 5 December 2012 the euro traded 8.4% above the level recorded at the end of August, but it remained 3.3% below the average level of 2011.

As regards other currencies, the exchange rate of the euro against the pound sterling has appreciated by 2.1% since the end of August and, on 5 December; it stood 6.5% below the average level of 2011. Over the period under review, the euro also appreciated against most other European currencies, depreciating only slightly against the Polish zloty amid the general improvement in financial market conditions sentiment across the continent. Since the end of August, the euro has also appreciated

against the currencies of most commodity exporters and large Asian countries.

8.5 Impact of Global Economic Development on Ethiopian Economy

The improvement in global economic activity has been reflected in the external sector of Ethiopia. Export earnings during second quarter of 2012/13 increased by 20.5 percent compared to last year the same period. Coffee which accounted 22.6 percent of the total export earnings during the reference period mainly contributed to this increment in export earnings along with a 14.9 percent growth in non-coffee exports.

Following the gradual economic recovery in the global economy, the receipts from private transfers raised by 58.9 percent during the second quarter of 2012/13 vis-à-vis last year same period. Estimated FDI inflows also increased by 4.8 and 16.2 percent in relation to last year the same period and the preceding quarter, respectively.

Despite increment in the volume of international oil price, fuel import bill has shown a 2 percent decline mainly due to a slight fall in international oil price.

Overall, the moderate improvement in global economic activity and ease in inflation leads the country's current and capital account to improve and there by balance of payments to get better off.