I. OVERVIEW

1.1 International Economic Developments

Global economy continues to grow at a modest pace, with the recovery slowly gaining some grip, 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 response 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 slowly.

In the United States, GDP growth slowed down strikingly 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 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 percent quarter on quarter, according to the preliminary estimate.

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 percent at the end of 2012, from 7.4 percent 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.

The improvement in global economic activity has been reflected in the external sector of Ethiopia. Export earnings during the second quarter of 2012/13 increased by 20.5 percent compared to last year same period. Coffee accounted for 22.6 percent of the total export earnings during the reference period. Non-coffee exports also showed a 19.4 percent growth. Similarly, receipts from private transfers surged 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 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, moderate improvement in global economic activity and ease in inflation would improve the country's current and over all balance of payments.

1.2 Macroeconomic Developments in Ethiopia

Inflation

During the second quarter of the fiscal year 2012/13, headline inflation scaled down to 0.4 percent vis-à-vis the 1.9 percent recorded in the previous quarter and 4.6 percent in the same quarter last fiscal year. Quarterly food inflation was 1.2 percent below zero from 0.9 percent in the preceding quarter and 4.8 percent a year ago. Core inflation also dropped to 2.9 percent from 3.4 percent in the first quarter of 2012/13 and 4.5 percent during the second quarter of 2011/12. In the review quarter, core inflation contributed 1.1 percent to the quarterly headline inflation offsetting a negative 0.7 percent downward contribution of food inflation.

Fuel prices

The price of crude oil in international market persistently declined during the review period and reached USD 88.13 per barrel from USD 92.69 per barrel recorded in the previous quarter.

Following the minor downward movement in international price, the government made adjustments on domestic fuel price. Accordingly, the average retail prices of fuel in Addis Ababa during the review period dropped to Birr 16.9 per liter, about 1.9 and 0.1 percent decrease annually and quarterly respectively.

Monetary Developments

Broad money supply (M_2) reached Birr 206.3 billion at the end of the second quarter of fiscal year 2012/13, revealing quarterly and annual growth rates of 7.4 percent and 32.3 percent, respectively. The annual growth rate was mainly attributed to the increase in domestic credit while the quarterly growth rate was due to expansion of domestic credit and net foreign asset.

On annual basis, domestic credit expanded by 35.6 percent due to 39 percent increase in credits to the non-central government and 2.1 percent rise in net credit to central government. Meanwhile, net foreign assets declined by 19.4 percent on annual, but a 1.1 percent growth on quarterly basis and reached Birr 39.8 billion at the end of the second quarter.

Reserve money was Birr 75.1 billion at the end of the second quarter, depicting 10.7 percent annual and 13.3 percent quarterly growth. Excess reserves of commercial banks also increased significantly on both annual and quarterly basis due to higher deposit growth.

The money multiplier measured by the ratio of broad money to reserve money, grew by 19.5 percent annually implying the increased monetization of the economy. Similarly, the ratio of narrow money to reserve money rose by 14.3 percent. Regarding other monetary ratios, narrow-money to broad money ratio decreased by 4.3 percent while quasi money to broad money ratio increased by 4.5 percent.

Interest rate

Average saving deposit rate remained at 5.4 percent. Weighted average time deposit rate, however, registered annual increase of 0.38 percentage point. Average lending rate was also unchanged at 11.9 percent. Meanwhile, weighted average yield on T-bills slightly rose from 2.13 percent to 2.27 percent on annual basis. However, considering annual headline inflation of 12.9 percent during the quarter under review, all deposit rates, lending rates and T-bill yields remained negative in real terms.

Financial Sector Developments

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

During the review quarter, 139 new bank branches were opened, raising the total number of bank branches to 1,515. As a result, the ratio of total bank branch to total population improved to 56,104.6∗ from 71,104.8 in the preceding quarter, reflecting a significant improvement in financial service outreach.

Similarly, the number of insurance companies operating in the country was 15, of which 14 were privately owned. The branches also increased to 255 from 227 compared to the same period last year. Of the total branches, about 54.5 percent were located in Addis Ababa. On the other hand, there are 31 micro-finance institutions (MFIs) operating in the country.

Meanwhile, the total capital of the banking system reached Birr 20.5 billion of which the share of the private banks was 48.3 percent. Commercial Bank of Ethiopia, the leading state owned bank, accounted for 36.9 percent of the total capital of the banking system. Total resources mobilized by the banking system (as measured by the sum of net change

∗ Computed based on the assumption that total population was 85 million in deposit mobilization, loans collected and net change in borrowings) rose by 56 percent against the preceding quarter due to a boost in net change in deposit offsetting a drop in net change in borrowing and a decline in loan collection. Similarly, total resources mobilized by the banking system scaled up by 20.6 percent on annual terms on account of a 49.4 percent increase in net change in deposit and 33.5 percent growth in loan collections.

At the same time, total disbursement of new loans by commercial banks (including DBE) reached Birr 14.1 billion, reflecting a 43.1 percent quarterly and 4.9 percent annual growth. Public banks disbursed Birr 7.3 billion (51.6 percent) while private banks jointly granted the remaining balance.

Sector wise, industry was the largest beneficiary of new loans having obtained Birr 5.2 billion (37.1 percent), followed by domestic trade (Birr 3.7 billion or 26.1 percent), international trade (Birr 1.7 billion or 11.8 percent), housing and Construction (Birr 1.6 billion or 11.2 percent) and agriculture (Birr 0.88 billion or 6.2 percent) among others.

During the quarter, the banking system collected Birr 9.6 billion, which was 33.5 percent higher than last year same quarter. Of the total loans collected, the share of private banks was Birr 4.6 billion (48.5 percent) while public banks collected Birr 4.9 (51.5 percent). About 66.4 percent of the quarterly loan collection was from private enterprises followed by state enterprises (24.9 percent) and cooperatives (8.1 percent).

Total stock of the banking sector credit (excluding credit to the central government) surged to Birr 121 billion at the end of the second quarter showing a 64.4 percent surge over the preceding quarter.

Similarly, outstanding credit of MFIs scaled up by 39.8 percent on annual basis to reach Birr 10.3 billion.

External Sector and Foreign Exchange Developments

Total merchandise exports increased by 2.6 percent on quarterly and 20.5 percent year - on- year bases, and amounted to USD 716.1 million. The annual increase in the exports was attributed to higher earnings from coffee (44.3 percent), oilseeds (61.5 percent), pulses (65 percent), gold (9.2 percent) and chat (11.5 percent).

Despite a 31.7 percent decline in international price USD 161.9 million receipts from export of coffee showed a 44.3 percent growth due to a 111.2 percent surge in its volume as compared to the same quarter a year before. However, coffee export recorded a 18.8 percent decline against the preceding quarter owing to both lower volume (7.5 percent) and international price (12.2 percent).

Total value of merchandise import during the second quarter of 2012/13 grew by 10.3 percent on annual and 13.1 percent quarterly basis and reached USD 3.1 billion. The annual increase was mainly attributed to higher imports of capital goods (41 percent) and semi-finished goods (20.8 percent). The 13.1 quarterly growth was due to higher import of capital goods (21.5 percent), semi-finished goods (35 percent) and consumer goods (6 percent). Hence, the trade deficit tended to widen, both in terms of quarterly and annual term.

The service account recorded USD 62.1 million net receipts, up from USD 141.4 million deficit last year same period. This was attributed to the rise in net transport services (39.9 percent) and government services (30.3 percent).

The current account balance (including official transfers) registered USD 773.3 million deficit during the second quarter of 2012/13, much lower than the USD 1.05 billion deficit a year ago due to improvements in net services and private transfers (58.9 percent).

The average official exchange rate of the Birr in the inter-bank foreign exchange market was Birr 18.0782 per USD showing a 1.2 percent quarterly and 5.4 percent annual depreciation. Similarly, the Birr in the parallel foreign exchange market depreciated by

1.6 and 5.0 percent in comparison to the previous quarter and last year same quarter, respectively to reach Birr 18.7333/USD. Therefore, the average spread between the official and the parallel market exchange rates widened to 3.6 percent in the review period from 3.2 percent in the preceding quarter, but narrowed compared to 4 percent in the same quarter of last year.

Federal Government Fiscal Operations

During the second quarter of 2012/13, total revenue and grants collected by the federal government was Birr 28.3 billion registering a 4.2 percent quarterly and 30.7 percent yearly growth.

Meanwhile, Federal government expenditure depicted a quarterly increase of 30.5 percent and reached Birr 28 billion. On annual basis government expenditure went up by 6.1 percent.

As a result, the overall fiscal balance (including grants) registered Birr 292 million surplus against Birr 4.7 billion deficit a year earlier.

Investment

A total of 1,745 investment projects with an aggregate capital of Birr 23 billion were licensed by the Ethiopian Investment Agency and Regional Investment Offices during the second quarter of 2012/13. The number of approved investment projects rose by 63.8 percent compared to last fiscal year.