I.OVERVIEW

1.1 International Economic Developments

The global economy continues to expand at a modest pace. Growth prospects in emerging markets seem to be losing some momentum, but there are signs that the outlook for growth is firming up in key advanced economies. The uncertain and fragile nature of the global recovery has been highlighted by the recent volatility in financial markets. Consumer prices picked up again in June in a number of advanced and emerging economies, but overall global inflation remains contained as a result of abundant spare capacity. Growth has started to gain some traction in a few advanced economies, but the pace of recovery is likely to remain moderate, as activity is restrained by ongoing balance sheet repair, fiscal tightening and continuing tight credit conditions in some countries. Growth prospects in emerging markets have softened recently as weaker domestic demand, tightening financing conditions in some countries and a weak external environment weigh on activity. However, growth in these economies remains substantially higher than in advanced economies, thereby making a significant contribution to global economic activity.

In the United States, real GDP growth accelerated in the second quarter of 2013. According to the "advance" estimate by the Bureau of Economic Analysis, real GDP increased at an annualized quarterly rate of 1.7 percent in the second quarter of 2013, up from the downwardly revised 1.1 percent growth recorded in the previous three months. The increase in the second quarter was driven by personal consumption expenditure although it had decelerated somewhat from the previous quarter and by strong private fixed investment, in both the non-residential and residential segments. In contrast, government consumption continued to be a drag on growth for the third consecutive quarter, although the decline in the second quarter was relatively small (-0.4 percent annualized), given that government consumption had already contracted substantially in the previous two quarters. Moreover, the contribution from net exports turned negative, with exports declining more than imports. Real disposable personal income declined significantly, driving the personal savings rate down to its lowest post-crisis level of 2.5 percent, compared with 5.3percent in the final quarter of 2012.

The Japanese economy continued to expand at a robust pace, with domestic demand and the external sector both contributing positively to growth. Sentiment indicators suggest further solid growth over the remainder of the year. On the domestic side, industrial production increased by 1.4 percent on a quarterly basis, although it dropped in June by 3.3 percent month on month. Growth in private consumption declined in June, although at a slower pace than in the previous month. Meanwhile, real exports and imports of goods increased in June by 2.0 percent and 3.1 percent month on month, respectively.

In the United Kingdom, economic growth gained momentum in the first half of 2013. Real GDP increased by 0.6 percent quarter on quarter in the second quarter of this year, according to the preliminary estimate. This increase was mainly due to growth in the services sector, although the industrial and construction sectors also made positive contributions. Despite the relatively strong growth dynamic during the first half of 2013, the pace of the economic recovery is likely to remain gradual. Private and public sector balance sheet adjustment, notwithstanding recent progress, is set to constrain domestic demand for some time, while prospects for export growth remain modest. Weak household real income growth is also likely to dampen domestic demand, although labour markets have remained relatively resilient, with the unemployment rate hovering just below 8 percent .On the other hand, In June 2013 the headline inflation rate increased by 0.2 percentage point to 2.9 percent. Looking ahead, the steady improvement in the main survey indicators in recent months suggests that the recovery will continue in the short term.

In China, data releases continue to point to a slowdown in the growth momentum. Real GDP growth decelerated to 7.5 percent in the second quarter of 2013, from 7.7 percent in the first three months of the year. Growth was driven by strong investment and, to a lesser extent, consumption. The sluggish external environment is a key factor behind the loss in the growth momentum. Given China's export-oriented economic structure, weak external demand together with the strengthening of the renminbi in the first half of the year weighed on exports, which declined in June compared with a year ago. Accordingly, manufacturing growth slowed down, as evidenced by a further decline in industrial production growth in June. Imports also declined, partly reflecting China's close integration in global supply chains. Credit and loan growth slowed down further in June, but remained well above nominal GDP growth.

In United Kingdom, annual CPI inflation has stayed relatively high amidst some volatility in recent months. This volatility has mainly been owing to one-off factors. In June 2013 the headline inflation rate increased by 0.2 percentage point to 2.9 percent, while CPI inflation excluding energy and unprocessed food remained steady at 2.5 percent. Looking ahead, it is expected that inflationary pressures will be contained by existing spare capacity in labor and capital utilization in the medium term. However, rises in administered and regulated prices, as well as the pound sterling's depreciation earlier this year, could put some upward pressures on inflation. At its meeting on 4 July 2013, the Bank of England's Monetary Policy Committee maintained the policy rate.

In China, Annual CPI inflation stood at 2.7 percent in June, well below the 3.5 percent target for 2013, while PPI inflation has remained negative since March 2012. Credit and loan growth slowed down further in June, but remained well above nominal GDP growth.

In bilateral terms, over the past month the euro depreciated slightly against most major currencies, including the US dollar (by 0.4 percent), the Japanese yen (by 1.2 percent) and the pound sterling (by 0.3 percent), amid changing expectations about future inflation differentials and interest rate developments. During this period, the euro broadly appreciated against the currencies of other EU Member States, as well as against the currencies of major emerging economies and commodity-exporting countries, including the Australian dollar (by 6.1 percent), the Canadian dollar (by 1.6 percent) and the Norwegian krone (by 4.5 percent). The currencies participating in ERM II remained broadly stable against the euro, trading at, or close to, and their respective central rates.

The slow growth in global economic activity has to some extent affected the external sector of Ethiopia. Export earnings during fourth quarter of 2012/13 declined by 13.9 percent compared to last year same period due to decline in the prices of major export commodities in the international market, slowdown in volume of some export item and sluggish recovery in major trading partners.

However, the slow growth in the global economy has not affected the inflows of workers remittance to Ethiopia. Year-on-year cash transfers rose by 20.6 percent presumably due to a strong increase in overseas employment especially in the UAE. FDI inflows also went up by 5.9 percent during same period.

1.2. Macroeconomic Developments in Ethiopia

Fuel prices

During the fourth quarter of 2012/13, the average price of Brent crude oil (in Europe), used as a point of reference for international oil price quotation in Ethiopia, stood at USD 94.2 per barrel, close to the price of USD 94.3 per barrel registered in the previous quarter and USD 93.4 per barrel recorded last year same period.

Accordingly, the domestic retail prices of petroleum products were adjusted and the average retail prices of petroleum products in Addis Ababa were revised down by 4.6 percent to Birr 16.8 /liter vis-a-vis the same period last year but remained unchanged compared to the preceding quarter.

Inflation

During the review quarter, headline inflation surged to 2.2 percent vis-à-vis 0.2 percent in the preceding quarter, but declined by 3.6 percentage point against last year same quarter. Quarterly food & non-alcoholic beverage inflation was 2.4 percent which scaled up by 3.1 percentage point whereas it dropped by 6.1 percentage point compared to a year ago. Core[1] inflation on the other hand, increased to 2.1 percent from 1.3 percent a quarter earlier. In the review quarter, food & non-alcoholic beverages contributed 1.2 percent to the quarterly headline inflation while that of core inflation was 1.0 percent.

[1] Unlike most countries it includes energy and administrative costs.

Monetary Developments

Broad money supply (M_2), which is the measure of monetary aggregate in Ethiopia, reached Birr 235.3 billion at the close of the fourth quarter of the fiscal year 2012/13, depicting quarterly and annual growth rates of 4.3 percent and 24.2 percent, respectively. The year -on -year increase was attributed to the growths in both net foreign assets (14.7 percent) and domestic credit (23.4 percent) while that of quarterly rise was due to a 8.3 percent expansion in domestic credit, counter balancing the drawdown of net foreign asset by 2.8 percent.

The 23.4 percent annual growth in domestic credit was ascribed to 26.2 percent increase in credit to the non-central government and 1.9 percent rise in net credit to central government.

Reserve money[2]reached Birr 74.9 billion at the end of the fourth quarter, depicting an annual and quarterly growth of 13.6 and 5.6 percent respectively. The annual growth in reserve money was exclusively due to about 20 percent expansion in currency in circulation. In the meantime, excess reserves of commercial banks, shown a significant annual surge presumably owing to higher deposit mobilization and reduction of reserve requirement from 10 to 5 percent as of March 2013, while it scaled down by about 24 percent on quarterly bases on account of their increased participation in weekly-bill market.

Interest rate

Average saving deposit and lending interest rates remained unchanged at 5.4 and 11.88 percent, respectively, both on quarterly and annual basis. Weighted average time deposit rate, however, registered annual increment of 3.0 percentage point. Similarly, the weighted average yield on T-bills slightly increased from 1.96 percent to 2.15 percent on annual basis. However, considering annual headline inflation of 7.4 percent during the quarter under review, all deposit rates and T-bills yields were negative in real terms whereas the average lending rate remained positive in real terms.

[2] Operational target of monetary policy framework of the National Bank of Ethiopia

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 19 as of end June 2013, of which 16 banks were privately owned.

During the review quarter, 112 new bank branches were opened, raising the total number of bank branches to 1,728. As a result, the ratio of total bank branch to total population went down to 49, 768.5[3] from 53,217.8, reflecting a significant improvement in financial service outreach.

At the same time, total number of insurance companies reached 16, of which 15 were private. The number of branches increased to 273 from 243 a year ago. Of the total branches, about 53.5 percent were located in Addis Ababa. Meanwhile, there were 31 micro-finance institutions (MFIs) operating in the country during the review period.

The total capital of the banking system reached Birr 23.4 billion at the end of the fourth quarter of 2012/13, of which the share of private banks was 48.4 percent. Commercial Bank of Ethiopia, the biggest state owned bank, accounted for 38.7 percent of the total capital of the banking system. The remaining balance (12.9 percent) was the capital of Development Bank of Ethiopia and Construction and Business Bank of Ethiopia.

During the review quarter, the total capital of the insurance industry increased by 24.1 percent on annual basis and reached Birr 1.5 billion. The capital share of private insurance companies stood at 74.7 percent.

Total resources mobilized by the banking system (as measured by the sum of net change in deposit, loans collected and net change in borrowings) surged by 28 percent over last year same period due to an increase in net change in borrowing, deposits and loan collections.

Total disbursement of fresh loans by the banking system reached Birr 13.4 billion, indicating a decrease of 19.0 percent compared to the same period of last year. Public

[3]Computed based on the assumption that total population was 86million(official CSA data)

banks disbursed Birr 7.5 billion (56.8 percent) while private banks did the remaining balance. About 82.2 percent of new loans went to private sector.

Sector wise, industry was the largest beneficiary accounting for Birr 4.4 billion (33.5 percent) followed by housing and construction Birr 2.3 billion (17.4 percent), Domestic trade Birr 1.9 billion (14.2 percent) agriculture Birr 1.6 billion (12 percent) and international trade Birr 1.3 billion (10.0 percent).

During the review period, the banking system collected Birr 13.2 billion in loans, about 18.9 percent higher than a year ago. Of the total loan collection, Birr 5.8 billion (43.6 percent) was attributed to private banks and Birr 7.5 billion (56.4 percent) to public banks. Nearly 86.7 percent of the loan was collected from private and 13.1 percent from public enterprises.

Total outstanding credit of the banking system (excluding credit to government and corporate bond) increased to Birr 135.8 billion at the end of June 2013, up by 2.2 percent over the preceding quarter. About 66.9 percent of the outstanding loan was on private sector.

External Sector and Foreign Exchange Developments

Total export at USD 847.9 million during the fourth quarter of 2012/13, decreased by 13.9 percent compared with the same quarter last year owing to lower export earnings from coffee (29.4 percent), gold (22.7 percent), oilseeds (14.3 percent), flower (7.5 percent) and live animals (15.3 percent). This decline was largely attributed to both lower volume and international price.

Coffee the main export item, depicted 11 percent decline in volume and 20.9 percent drop in price during the review period. Hence, the share of coffee export in total export earnings decreased to 27.3 percent from 33.3 percent last year same period.

Meanwhile, total imports fell by 5.3 percent down to USD 2,669.3 million from USD 2,819.1 million last year. This was mainly attributed to the slowdown in imports of capital goods (3.2 percent), fuel (11.1 percent), semi-finished goods (26.2 percent) and raw material (8.3 percent).

Thus, the trade deficit at USD 1821.4 million was slightly lower than USD 1835 million recorded a year earlier.

The net receipt from export of services stood at USD 166.2 million, up from USD 157.3 million registered last year same period. The quarter-on-quarter increase in net service receipts was due to the rise in net transport services (184.1 percent) and decline in other services payments (20.8 percent).

Likewise, the quarterly rise in net service receipts was due to an increase in transport service (66.8 percent) and investment income (10.1 percent) despite decline in net receipts from travel (15.1 percent), government services.

The current account balance (including official transfers) registered USD 666.1 million deficit during the fourth quarter of 2012/13, much higher than the USD 547.6 million deficit recorded last year same period. The decline in export (13.8 percent), private transfers (1.4 percent) and official transfers (57 percent) contributed to the widening of the current account deficit.

In the review period, the capital account recorded USD 771.0 million in surplus which was 46.6 percent higher than last year same period. The improvement in the capital account balance was due to the rise in official long term disbursement net (68.5 percent) and foreign direct investment (5.9 percent)

In the interbank foreign exchange market, the average official exchange rate of the Birr depreciated by 5.6 percent compared to last year same period and reached Birr 18.5331/USD. Likewise, the parallel market average exchange rate was depreciated by 9.2 percent relative to the rate a year ago. Consequently, the premium between the official and parallel market rates in the review quarter widened to 9.0 percent from 5.4 percent in same quarter last year.

Federal Government Fiscal Operations

During the fourth quarter of 2012/13, total revenue and grants of the Federal Government amounted to Birr 23.5 billion, depicting a slight decline (0.5 percent) against last year same period. The quarterly performance of total revenue and grants accounted for 22.7 percent of the annual plan. On the other hand, the Federal Government's total expenditure rose by 27.4 percent over the same period last year, and reached Birr 38.0 billion due to the increase in capital expenditure (20.4 percent), regional transfer (42.7 percent) and current expenditure (13 percent). The quarterly expenditures constituted 31 percent of the annual budget. As a result, the overall fiscal balance (including grants) showed Birr 14.6 billion in deficit compared to Birr 6.25 billion deficit registered a year ago.

Investment

A total of 1,401 investment projects with an aggregate capital of Birr 29.3 billion were licensed by the Ethiopian Investment Agency and Regional Investment Offices during the fourth quarter of 2012/13 with projects showing 12 percent and capital 126 percent annual growth rates.