# I.OVERVIEW

## 1.1 International Economic Developments

Global growth remains solid, despite a reasonable slowdown in the first quarter of 2014 as a result of the adverse impact of temporary factors, such as the unusually cold winter in the United States and the shutdown of heavy-industry plants in China for environmental reasons. The shift in growth dynamics continues across regions, with momentum building up in advanced economies, but faltering in major emerging market economies on the back of economic and geopolitical uncertainties. Concerns about a possible escalation of tensions between Ukraine `and Russia have increased uncertainty regarding the outlook for this region and the world economy as a whole. Generally, global sentiment indicators have remained rather resilient so far, rebounding at the end of the first quarter.

In the United States, real GDP growth scaled down sharply in the first quarter of 2014, largely reflecting uncommonly severe weather conditions that depressed economic activity. According to the first estimate by the Bureau of Economic Analysis, real GDP increased at an annualized rate of 0.1 percent (0.0 percent quarter on quarter), down from 2.6 percent (0.7 percent quarter on quarter) in the previous quarter. The slowdown in the first quarter, compared with the previous quarter, reflected largely the slowdown in non-residential investment, predominantly equipment investment, exports and a negative contribution to growth from inventory building. On a more positive note, personal consumption expenditure held up relatively strongly, while government spending and residential investment declined at a slower pace than in the previous quarter. Looking ahead, USA's economic activity is expected to accelerate during this year, supported by a further strengthening of private domestic demand, reflecting continued accommodative financial conditions and improving confidence, and by a diminishing fiscal drag.

In Japan, real GDP growth slowed to 0.2 percent quarter on quarter during the third and fourth quarters of 2013, from 1.0 percent during the second quarter. Latest hard data for March point to a pick-up in activity during the first quarter of 2014. Retail sales surged by 11.0 percent year on year in March following growth of 3.6 percent year on year in February, while imports also increased, consequently widening the seasonally adjusted trade deficit in March. The rapid increase in retail sales and higher imports in March can be partly attributed to a frontloading of demand in advance of the consumption tax increase from 5 percent to 8 percent on 1 April 2014. furthermore, industrial production increased by 0.3 percent month on month in March, according to preliminary figures, reversing some of the 2.3 percent contraction in February. As expected, the latest sentiment indicators point to a loss of economic momentum during the second quarter following the consumption tax increase and the frontloading of demand during the first quarter.

According to the preliminary estimates, economic activity in the United Kingdom maintained strong momentum in the first quarter of 2014. Real GDP growth accelerated further to 0.8 percent quarter on quarter. Although a breakdown of demand components is not available, output growth appears to have been supported by stronger private consumption, in turn reflecting ongoing improvements in employment and low inflation, as well as the sustained momentum of investment, which is continuing to recover from low levels. Looking ahead, the robustness of the economic recovery is subject to some uncertainty. Despite some signs of improvement, disappointing dynamics in productivity growth, coupled with the need for private and public sector balance sheet adjustment, may constrain growth in real incomes and, thus, domestic demand.

In China, economic activity weakened in the first quarter of 2014 on account of lower manufacturing activity as well as some temporary factors. GDP growth slowed to 7.4 percent year on year, from 7.7 percent in the fourth quarter of 2013. On a quarterly basis, growth declined to 1.4 percent in the first quarter of the year, from 1.7 percent in the previous quarter. Slower growth had already been reflected in a broad range of monthly indicators, such as industrial production, housing activity and retail sales. The slowdown was broad-based, but most visible in the secondary industries as authorities try to downsize industries with overcapacity while also addressing environmental concerns linked to air pollution. From a demand perspective, consumption contributed most to growth, while the contribution by net exports was at its most negative since late 2009. In line with the weak trade data over the first quarter of the year, the current account surplus dropped to 0.3 percent of GDP, from 1.5 percent of GDP in the previous quarter. Despite this, China's foreign reserves continued to rise in the first quarter of 2014, reaching USD 3.9 trillion, or 42 percent of GDP, as net international capital flows, including foreign direct investment, continued to be positive.

In the largest central and eastern European (CEE) EU Member States, the recovery in economic activity has continued, supported by strong exports, although the pace of domestic demand has also picked up. Looking ahead, economic activity is likely to continue to strengthen in 2014, with an increasing role for domestic demand, in particular investment, which is likely to be supported by the absorption of available EU funds. Exports should also contribute to growth.

In Russia, real GDP in the third quarter of 2013 rebounded slightly from the weak levels of activity observed earlier in 2013, but remained subdued, growing by 0.2 percent quarter on quarter, as investment rose at a sluggish pace and a strong increase in private consumption was largely offset by higher imports. It is anticipated that foreign demand, together with some pick-up in private investment, will have bolstered output at the start of 2014.

In India, real GDP growth remains subdued. Having rebounded in the third quarter of 2013, real GDP growth moderated to 4.6 percent year on year in the fourth quarter of 2013 on account of weaker growth in investment and exports.

## 1.2. Macroeconomic Developments in Ethiopia

### Fuel prices

During the third quarter of the fiscal year 2013/14, the average price of crude oil was USD 107.9 per barrel, scaling down slightly against the USD 112.9 and USD 109.4 per barrel registered in the previous year same quarter and the preceding quarter, respectively.

The average retail price of fuel in Addis Ababa increased to Birr18.51 per liter; showing an average increment of 9.3 and 5.1 percent vis-à-vis the same period of last year and the preceding quarter, respectively.

### Inflation

During the third quarter of the fiscal year 2013/14, general inflation slowed down to 0.4 percent from 1.3 percent in the previous quarter on account of 2.5 percentage point slowdowninfood & non-alcoholic beverages inflation, offsetting 0.8 percentage point increase in non-food inflation. Quarterly food & non-alcoholicbeverage inflation decelerated to -2.1percent against 0.3 percent during the previous quarter while non food inflation slightly rose to 3.1 percent from 2.3 percent over the same period.Non-food inflation contributed 1.5 percent to the quarterly general inflation of 0.4 percent counterbalancing the 1.1 percent below zero inflation in food and non-alcoholic beverage items.

## Monetary Developments

At the close of the third quarter ended on 31 March 2014, domestic liquidity measured by broad money supply ($M_2$) reached Birr 273.5 billion, revealing annual and quarterly growth rates of 21.2and 8.4 percent, respectively.The expansion in broad money supply was exclusivelydriven by 29.4 percent surge in domestic credit offsetting a 21.7 percent slowdown in net foreign assets of the banking system.Year-on-year, domestic credit increaseddriven by 62.9 percentsurge in credit extended to the government sector and 27.2 percent to non-government sector.

Meanwhile, reserve money reached Birr 84.5 billion at the end of the third quarter of 2013/14that depicts an annual increment of19.1 percent and quarterly growth rate of 16.9 percent.

Excess reserves of commercial banks, however, decreased by 19.6 percent on annual basis,in contrast with38.8 percentquarterly growth. The annual decrease in excess reserves was mainly due to anincrease in credit to deposit ratio from 96.5 to 98.7. Moreover, Commercial Banks loan has registered an annual increase of 22 percent.

## Interest rate

Average savings deposit and lending rates remained unchanged at 5.4 and 11.88 percent, respectively, while weighted average time deposit rate showed a 5.2 percentage point annual increase.Weighted average yield on T-bills, however, slightly decreased from 1.53 percent to 1.26 percent on annual terms.Considering annual headline inflation of 8.8 percent during the quarter under review, all deposit rates and the t-bills yields remained negative while average lending rate was positive in real terms.

## Financial Sector Developments

Banks, insurance companies and microfinance institutions are the majorformal financial institutions operating in Ethiopia. The number of banks has reached 19as at the end of March2013, of which 16 banks are privately owned. During the review quarter, 93new bank branches were openedraising the total number of bank branches to 2,108.Consequently, the ratio of total bank branch to total population improved to 41,088 from 42,985 in the preceding quarter, reflectingimprovement in financial service outreach.

About 34 percentof the total bank branches are located in Addis Ababa.The share of the private banks in total bank branches increased to 53.8 percent from 47.5 percent in the preceding quarter due to their opening of 77 new branches compared with 16 new branches opened by public banks during the review quarter.

In the meantime, the total capital of the banking system increased by 2.8 percent compared to the preceding quarter and reached Birr 25.6 billion, of which private banks jointly took 53.9 percent. Commercial Bank of Ethiopia, the state owned bank, alone accounted for 35.3 percent of the total capital of the banking system while the remaining balance (10.8 percent) was that of Development Bank of Ethiopia and Construction & Business Bank.

The total number of insurance companies operating in the country stood at 17 of which 16 were privately owned. The number of their branches increased to 323 from 293 a quarter earlier. About 54.8 percent of branchesare located in Addis Ababa.

The insurance industry also recorded a6.6 percent quarterly increase in capitalwhich stood at Birr 1.9 billion at the close of the review quarter. The share of private insurance companies in total capital stood at 78.5 percent.

In addition, there are 31 micro-finance institutions (MFIs) operating in the country whichhave mobilized a total saving deposit of Birr 10.2 billion, about 47.1 percent higher than the amount mobilized last year same quarter. Similarly, outstanding credit of the MFIs scaled up by 31.7 percent on annual basisto reach Birr 14.2 billion. As a result, their total assets increased by 36.8 percent and stood at Birr 22.6 billion by the end of March 2014. MFIs are highly contributing to poverty reduction in asset creation by providing loans to and mobilizing savings from low-income segments of the population.

Total resources mobilized by the banking system, the sum of net change in deposit, loans collected and net change in borrowings grew by 27.3 percent vis-à-vis the preceding quarter and 30.6 percent quarter-on-quarter basis.

Meanwhile, total fresh loandisbursement by the banking system amountedto Birr 15.5 billion, indicating a 7.5 and 8.6 percent quarterly and annual decline, respectively. Of the total new loan disbursement, public banks disbursed Birr 10.9 billion (70.2 percent) andprivate banks the remaining balance.

The banking system collected Birr 12.4 billion, which was 46.9 percent higher than last year same quarter. Of the total loan collected, private banks'share was Birr 6.4 billion (51.7 percent) while that of public banks was Birr 5.96 billion (48.3 percent). About 71.3 percent of the loan was collected from the private enterprises followed by public enterprises (17.5 percent) and cooperatives (11.1 percent).

Total outstanding credit of the banking System (excluding credit to the central government) increased to Birr 162.95 billion at the end of March 2014, up by 7.7 percent on quarterly basis.About 98.5 percent of the outstanding loan of the private banks was claims on private enterprises.

## External Sector and Foreign Exchange Developments

Total earnings from merchandise exports scaled up by 11.8percent on annual and 33.5 percent on quarterly basis to reach USD 909.4 millionin the third quarter of 2013/14. The annual rise in the export earnings was attributed to higher receipts from oil seeds (62.2 percent), coffee (7.9 percent), pulses (22.7 percent), chat (4.6 percent), flower (14.3 percent) and leather&leather products (5.7 percent).

The unit value of coffee actually received by exporters fell by 4.4 percent on quarter-on-quarterbut rose by 11.1 percent on quarterly basis. Although the current global coffee market conditiongloomy, the volume of coffee exports in the review period significantlyincreased by 74.1 percent and 13.0 percent vis-à-vis the previous quarter and last year same quarter,respectively. The value of export of coffee in the third quarter of 2013/14 increased to USD 164.9 million from USD 152.8milliona year ago. The share of coffee export in total export earnings declined slightly to 18.1 percent from 18.8 percent during the same period.

Total value of merchandise import during the review quarter stood at USD 3.7 billion, depicting a5.6 percent increase over the preceding quarter owing to higher imports of capital goods (16.7 percent), fuel (20.7 percent) and semi-finished goods (9.8 percent). The surge in the imports of capital goods in turn was due to an increase in import value of industrial goods (32.7 percent). Compared to last year same quarter, total import increased by 23.3 percent largelydue to 43.6 percent surge in the value of import of capital goods followed byconsumer goods (6.7 percent), fuel (10.6 percent), semi-finished goods (28.0 percent)and raw materials(14.2 percent).

In contrast, total net transfer receipts from the rest of the world scaled down by 6.7 percent compared to last year same quarter toUSD 1.2 billion as net official transfers decreased by 39.6 percent despite 3.7 percentincrease in private transfers.Relative to last year same period, net private transfers increased by 3.7 percent during the review quarter and amounted to USD 1 billion on account of the 24.6 percent rise in cash remittances from private individuals that more than offset the 23.0 percent decline in NGO transfers.

The current account balance (including official transfers) registered USD 1.6 billion in deficit during the third quarter of 2013/14, which was higher than USD 796.6 million deficit recorded a year ago. This was attributed to the decline in net official transfers (39.7 percent) and a widening of trade deficit (23.3 percent). In the mean time, the capital account showed USD 442.2 million in surplus; about 54.4 percent lower than last year same period as a result of slowdown in inflows of net official long-term capital (70.2 percent), other public long-term capital (311.9 percent), foreign direct investment (14.9 percent) and short-term capital (172.4 percent).

In the inter-bank foreign exchange market, the average official exchange rate of the Birr depreciated by 4.8 percent and 1.3 percent compared to last year same quarter and the preceding quarter, respectively, to reach Birr 19.1819/USD. On the otherhand, the parallel market average exchange rate stood at Birr 19.8222/USD,appreciated by 0.1 percent vis-à-vis last year same quarterbut depreciated by 1.4 percent against the preceding quarter.

As a result of a relatively faster rate of depreciation of the Birr in the official market, the premium between the official and parallel market narrowed to 3.3 percent from 8.4 percent in same quarter last year but widened marginally against 3.2 percent in the previous quarter.

Meanwhile, REER of the Birr appreciated both on quarterly and annual basis by 1.2 percent and 4.4 percent, respectively due to relatively higher domestic inflation compared to that of major trading partner countries. NEER, however, depreciated by 0.2 against the preceding quarter and by 1.2 percentcompared to the same quarter last year.

## Federal Government Fiscal Operations

Total revenue and grants of the federal government collected during the third quarter of 2013/14 increased by 26.2 percent over the same period last year and amounted to Birr 27.8 billion. Likewise, total expenditure showed 8.5 percent increase vis-a-vis a year ago. Consequently, the overall fiscal balance of the federal government (including grants) registered Birr 5.4 billion deficit compared to Birr 8.6 billion deficit recorded last year same quarter.

## Investment

The Ethiopian Investment Agency and Regional Investment offices offered investment licenses for about 1,359projects with a total capital of Birr 39.8billion during the third quarter of 2013/14. The number of approved investment projects increased by 21.9 percent on quarterly basis,despite the decline in the registered investment capital by 20.8percent.