PRESENTATION ON: MACROECONOMIC DEVELOPMENTS IN ETHIOPIA

To

Japan Business Community

National Bank of Ethiopia

July 27, 2011

Addis Ababa

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Summary of Major dev’ts

For the past six years, on average:

- Ethiopian Economy grew 11.3 percent
- Agr, Indust and Service- 9.2, 9.9 and 14.1 percent, resp.
- Export & Import of goods & services-18.4 and 21.9 percent, in their order.
- Remittance & FDI 21& 37percent, resp.
- Bank deposit- 20.3 percent
- Broad money- 20.2 percent

2010/11vis-a-vis 2009/10

- Economy expected to register 11 percent growth (meet baseline scen), with industry to play the leading role.
- Export of goods and services expected to rise 42 percent, even above the 6 years average.
- Import of goods & services – 19.8 percent
- Remittance went up significantly by 88 percent, above 6 years average.
- FDI surged 7 percent
- Average official exchange rate depreciated 25 percent, more than the parallel deprec. Rate. Hence, narrow, premium.
- REERI depicted 7 percent deprec., improved external competitiveness.
- Deposit mob. By banks- 19 percentage points rise up
- Gross domest. Saving- expected to increase to 7 percent of GDP from 4.6 percent in last year.

Cont’d

On the contrary:

- Annualized headline, food and non- food inflation rapidly accelerated to show 15.3, 21.1 and 3.6 percentage points growth.
- Broad money depicted a growth above the 35 percent target for the year.

In 2010/11 to 2014/15

- The economy projected to grow on average by 14.9 percent.
- Industry sector expected to be the leading sector followed by agriculture and service sectors, respect.

II. Inflation trend & Measures taken

2.1. Inflation Trend in Ethiopia

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As shown in table 2,

- Annualized inflation (Measured by 12 months moving average) was 36.4 percent in June 2009. Then after, it continued to decline and reached 2.8 percent in June 2010. However, the situation reversed back and inflation again rise up to 18.1 percent in June 2011.
- Food inflation also went down below zero to 5.4 percent in June 2010 from 44.3 percent in June 2009. But, crept up to 15.7 percent in June 2011.
- Non-food inflation dropped to 18.2 percent in June 2010 from 21.7 percent a year ago. But again surged to 21.8 percent in June 2011.

Trend cont'd

- ***What contributed to the recent soar in inflation****?*

i. Imported Inflation

a. Both food and non food, but largely of food attributed to the surge in inflation. Of food components, tradable food items like coffee, pulses, oil &fats, spices, vegetables & fruits etc were responsible, *which implied the rise in world price of such commodities directly translated to domestic inflation*.

- – For instance: look at non- tradable cereal inflation: deflation of 5% has been witnessed in June 2011.
- – Excluding the tradable items, annualized headline, food and non- food inflation in June 2011 slowed down to single digit of 5.8, 4.2 and 8.2 percent, respectively.

Trade cont'd

b. Surge in price of fuel at the international market, owing to supply-demand imbalance as a result of *political instability in the middle east and North Africa*.

ii. Malfunctioning trade practices

- The trade practice of the country was *oligopolistic nature*, where few business men control the market and thereby determine prices as they like even at retail level. *Though not the main cause but exacerbated the speed of inflation*.

iii. The rise in money supply due to increase in reserve money by more than expected for 2010/11. this also aggravated the situation *"just like adding fuel on a fire"* why?

- Extraordinary forex earning in 2010/11 as a result of improved performance recorded in export, remittance, service and FDI. *Hence, the country' months of import reserve coverage in 2010/11 grew up to 3.2 months from 2.1 months targeted for the year.*

To conclude: *all these showed the 2/3rd share of domestic inflation was b/c of imported inflation and the rest due to money supply and others.*

2.2. Measures taken to Curb Inflation

Though we would remain as price takers in the international market, the government has planned to take:

Tight monetary and fiscal policy measures along with necessary administrative measures. Among others, include:

- *Sterilization* of excess foreign currency reserves by the Central Bank (till now around USD 400 million has been sold to CBs)
- *Zero central bank financing* of government deficit in 2011/12
- *3.9 percent drop in reserve money in 2011/12*

III.Price cap and Inflation

Why price cap was imposed by the Government?

- The trade practice of the country was *oligopolistic nature* where few business entities control the market and thereby determine prices as they like even at retail level.
- This entails the short time intervention by the government so as to break it and reverse the market to normal i.e *imposition of price cap*.
- During imposition, supply side effect was expected and to mitigate it, government has imported the commodities in bulk and distributed via consumers' cooperatives and now supplying to various shops to distribute.

Conclsion: price cap not at all related to inflation

Price cap cont’d

When lifted & why?

- As a short period instrument in a market economy, imposition of price cap stayed for not more than 6 moths.
- It is lifted for commodities except 3 (sugar, oil & wheat), b/c government took the necessary *measures on those destabilizing the market* and besides *commence the implementation of trade laws* which expected to resolve the aforementioned problem.

IV. Lending cap/ Credit cap & Inflation

What is lending cap?

- It is one of the direct monetary policy instrument exercised by central banks.
- It usually used to affect inflation through limiting commercial banks credit.

Why is it imposed by NBE?

- During 2008, annualized inflation in Ethiopia was higher (in the range of 20-30%). At that time inflation had somewhat *monetary phenomena* due to over heated economy.
- This calls for a policy intervention and the central bank limited government borrowing and took indirect policy measures such as:
  - Raising RRR from 10 to 15% of net deposit.
  - Asset liquidity ratio from 15 to 25%.
  - Issuance of T-bills

Lending cap cont'd

- But as these policy measures *alone were not effective* to achieve the intended objective, in conjunction with the indirect ones, the central bank obliged to take the direct policy measures *(imposition of credit ceiling in September 2008*), which directly affect credit extended by commercial banks. As a result of the combined effect of tight monetary and fiscal policy measures, annualized inflation persistently dropped and stood at 2.8 percent in June 2010.
- *When &why credit cap lifted?*
  - The credit cap was lifted by the central bank on April 1, 2011.
- Why lifted? As the monetary impact on inflation believed to be brought under control.

THANK YOU

Questions or Comments?