IX. INTERNATIONAL DEVELOPMENTS

9.1 International Economic Developments

9.1.1 Overview of World Economy

The global economy expanded vigorously in 2006, growing by 5.4 percent. This growth momentum is expected to continue in 2007 with growth projected at above 5 percent. The strong growth in the global economy is due to the continued very high growth rates in emerging economies despite slowdown in the US economy.

The US economy continued to suffer as a result of the problems in the housing market coupled with slowdown in corporate investment in plant and equipment. On the other hand, consumption remained strong due to continued employment growth. The growth rate of the US economy is projected to decline to 1.9 percent in 2007 from 2.9 percent in 2006.

In 2006, economic growth accelerated to its fastest pace in six years in the Euro area. The 2.8 percent growth rate registered in the Euro area was the result of a boost in domestic demand and improved labour market. However, it is expected to slowdown to 2.5 percent in 2007 and 2.1 percent in 2008 due to the effect of euro appreciation, trade spill over from the US and difficult financing conditions.

Despite a slow-down in the middle of 2006, economic activity in Japan regained momentum towards the end of the year and growth reached 2.2 percent. If is, however, expected to decline to 2 percent in 2007 and 1.7 percent in 2008 reflecting slower global growth and stronger yen.

Rapid growth in emerging market and developing countries was led by China and India. China's growth rate reached 10.8 percent in 2006, driven by investment and export growth while in India economic growth picked up to 9.3 percent. Growth was also high in other emerging markets and developing countries supported by high commodity prices and favorable financial conditions. Growth in these countries is expected to be strong in 2007 and 2008. Among emerging markets and developing countries, the Chinese economy is expected to grow by 11.5 percent in 2007 and 10 percent in 2008.

Growth remained very strong in sub-Saharan African countries also reaching 5.7 percent in 2006. Both oil exporting and oil importing countries contributed to this sustained economic growth. Economic growth is expected to accelerate to 6.1 percent in 2007 and 6.8 percent in 2008 largely reflecting the coming on-stream of new production facilities in oil exporting countries such as Angola and Nigeria. However, most other countries in the region are also expected to maintain high rates of growth.

Table 9.1:- Overview of the World Economic Outlook and Projections

(Annual Percentage Changes)

			Projection	
	2005	**2006**	**2007**	**2008**
World Output	**4.8**	**5.4**	**5.2**	**4.8**
Advanced Economies	2.5	2.9	2.5	2.2
United States	3.1	2.9	1.9	1.9
Euro Area	1.5	2.8	2.5	2.1
Japan	1.9	2.2	2.0	1.7
Other Emerging Markets and Developing Countries	7.5	8.1	8.1	7.4
World Trade Volume (goods & services)	**7.5**	**9.2**	**6.6**	**6.7**
Imports				
Advanced Economies	6.1	7.4	4.3	5.0
Other Emerging Markets and Developing Countries	12.1	14.9	12.5	11.3
Exports				
Advanced Economies	5.8	8.2	5.4	5.3
Other Emerging Markets and Developing Countries	11.1	11.0	9.2	9.0
Commodity Prices				
Oil	41.3	20.5	6.6	9.5
Non-oil	10.3	28.4	12.2	-6.7
Consumer Prices				
Advanced Economies	2.3	2.3	2.1	2.0
Other Emerging Markets and Developing Countries	5.2	5.1	5.9	5.3

Source: IMF, World Economic Outlook, October, 2007

9.1.2 World Trade

The volume of world trade in goods and services grew by 9.2 percent in 2006 and it is expected to expand by 6.6 percent in 2007 and 6.7 percent in 2008. The growth in imports of the advanced countries, which was 7.4 percent in 2006 is to slowdown to 4.3 percent in 2007. Similarly, the growth in exports of these countries is envisaged to decline to 5.4 percent in 2007 from 8.2 percent in 2006. Other emerging markets and developing countries exports grew by 11 percent in 2006 while their imports rose by 14.9 percent. Growth in exports of these countries is expected to slow down to 9.2 percent in 2007 while their import growth is also expected to decline to 12.5 percent.

Global trade imbalance remained very large in 2006. The US current account deficit reached 6.2 percent of GDP during the year while China's current account surplus was 9.4 percent of GDP. Due to the recent real effective depreciation of the US dollar and a more balanced global demand growth, the US current account deficit is expected to decline to 5.5 percent of GDP in 2007. However, global imbalances are expected to remain very large in the near future. Sustained global imbalances are feared to prompt rising protectionist pressures.

9.1.3 Inflation and Commodity Prices

Inflation has been contained in the advanced economies, but it has risen in many emerging and developing countries, reflecting higher energy and food prices. Inflation in advanced economies is expected to decline to 2.1 percent in 2007 while inflation in emerging markets and developing countries is to rise to 5.9 percent from 5.1 percent in 2006.

Global credit market conditions have deteriorated sharply since late July as a repricing of credit risk sparked increased volatility and a broad loss of market liquidity. Initially, rising delinquencies on U.S. subprime mortgages led to a spike in yields on securities collateralized with such loans and to a sharp widening in spreads on structured credits, particularly in the United States and the euro area. From mid-August, rising uncertainty about the amount and distribution of associated valuation losses and concerns about the off-balance-sheet exposures of financial institutions have added to market strains. The result has been a drying up of high-yield corporate bond issues, a sharp contraction in the asset-backed commercial paper market, a dramatic disruption of liquidity in the interbank market, and stress on institutions funded through short-term money markets.

Prior to the recent turbulence, central banks around the world were generally pushing up policy rates to head off nascent inflationary pressures. However, in August, faced by mounting market disruptions, central banks in the major advanced economies injected liquidity through open market operations to stabilize overnight interest rates. They also facilitated access to their discount windows, and in the United Kingdom, the authorities extended deposit insurance coverage to reassure depositors after a bank experienced difficulties. In September, the Federal Reserve reacted to rising risks to growth by lowering the federal funds rate by ½ percentage point, and market participants expect further reductions in the coming months. Moreover, expectations of policy tightening by the European Central Bank (ECB) and the Bank of Japan (BoJ) have been rolled back. Central banks in a number of emerging market countries (e.g., Argentina, Kazakhstan, and Russia) also provided liquidity to relieve strains in interbank markets, but for others the principal challenge has continued to be addressing inflation concerns (Chile, China, and South Africa have all raised interest rates since August).

In the commodity market, prices have generally been increasing during the first eight months of 2007. The IMF commodities and energy price index rose by 21 percent during this period largely driven by resurgence in oil prices and rising metals and food prices. Oil prices rose to all time highs and came close to USD 100 per barrel in September 2007 as a result of sustained demand growth in the face of limited supply. Food prices have also been rising driven by strong demand-particularly for biofuel production- and supply shortfalls.

Oil prices are expected to remain high as a result of continued geopolitical and supply risks coupled with stronger demand especially from China, the Middle East and the United States. On the other hand, prices of metals and food are expected to moderate.

9.1.4 Exchange Rates

After falling for most part of the year, the U.S. dollar temporarily regained some ground in August in the context of recent financial turbulence, but has since resumed a weakening trend, against the background of a wide current account deficit, a slow-growing economy, and the cut in the federal funds rate. In contrast, the euro has continued to strengthen. The pound sterling and the Canadian dollar have also appreciated in real terms. Despite Japan's rising current account surplus, the yen depreciated somewhat more rapidly through June as continued low interest rates and a waning home bias of Japanese investors encouraged capital outflows. However, it has rebounded since then, as heightened market volatility has prompted some unwinding of yen carry trades. The Chinese renminbi has continued to appreciate gradually against the U.S. dollar, and its real effective exchange rate has risen modestly in recent months. Nevertheless, China's current account surplus has widened further, and its international reserves have continued to soar, reaching USD 1.4 trillion at the end of August 2007.

9.1.5 Capital Flows

Net capital inflows to emerging and developing countries fell to USD 55.1 billion in 2006 compared to a net inflow of USD 124.7 billion in 2005 mainly as a result of private portfolio outflows. Direct investment inflow to emerging and developing countries also slightly declined from USD 262.7 billion to USD 258.3 billion. In 2007, net capital inflows is expected to surge to USD 363.3 billion mainly as a result of the expected reversal of private portfolio outflows and higher inflows of other private capital.

Net private capital flows to African countries which was USD 20.1 billion in 2005 went down to USD 5.6 billion in 2006 as a result of higher outflows in other private capital. Private direct investment to Africa amounted to USD 20.4 billion in 2006 which accounted for a mere 8 percent of the total private direct investment inflows to emerging and developing countries. Net capital inflows to African countries are expected to rise to USD 47.6 billion in 2007.

9.2 Implications of International Economic Developments on the Ethiopian Economy

The continued robust growth in the global economy is expected to sustain the current high growth of Ethiopia's export earnings by boosting demand for export commodities.

Very high oil prices in the international market, however, continue to pose the major risks to the domestic economy. The sustained rise in oil prices is expected to increase the country's oil import bill thereby exacerbating the current account deficit. In addition to this, higher oil prices in the international market are bound to affect domestic prices.

This, in turn, would play a part in contributing to the already high rate of inflation in the economy.

The continued weakening of the US dollar against other major currencies is expected to improve the external competitiveness of the country. However, it is also expected to raise the cost of imports denominated in currencies other than the US dollar particularly the euro.

9.3 Highlights of Important International Meetings

9.3.1 Intergovernmental Group of Twenty-Four[1] Meeting

During their seventy-eighth meeting held on October 19, 2007, in Washington, Ministers of the Inter-Governmental

[1] The Intergovernmental Group of Twenty-Four on International Monetary Affairs and Development (G-24) was established in 1971. Its main objective is to concert the position of developing countries on monetary and development finance issues.

Group of Twenty-Four on International Monetary Affairs and Development discussed financial market turbulence and economic outlook, voice and representation in Bretton Woods Institutions (BWIs), World Bank group's long-term strategy, the climate change agenda, and other issues.

With regard to the first issue, the ministers underlined that uncertainties persist in the outlook of the world economy and that the balance of risks appears to be on the downside. Ministers stressed the importance of vigilance and of distilling lessons from the recent turbulence.

They also noted the need to improve the Fund's surveillance of advanced economies, putting as much focus in evaluating their vulnerabilities as it does in emerging market economies. In the current financial context, Ministers also highlighted the importance of addressing the potential impact of volatile capital flows and noted that emerging markets and developing countries would be in a better position to face this challenge if they could have more confidence in receiving timely multilateral financial support. They also underlined that active policy coordination is critical to prevent the emergence of a larger crisis.

Ministers expressed concern about the rising sentiment of protectionism in trade and investment in advanced countries and underlined the importance and urgency of a successful conclusion of the multilateral trade negotiations and called upon the IMF and the World Bank to work with the WTO in making a strong case for the elimination of agricultural subsidies and improvement in market access by advanced countries.

Regarding the second issue, ministers reiterated the importance of a significant redistribution of voting power in favor of emerging market and developing countries as a group and stressed that this redistribution should not be at the expense of other emerging market and developing countries.

Ministers agreed that a redistribution of quotas should be the direct outcome of a simple, transparent and robust formula and should include a GDP blend with a strong component measured in purchasing power parity terms, correct the measure of variability and increase its weight relative to openness to better reflect vulnerability. They also stressed the importance of implementing a regular process of quota reviews and adjustments independent of liquidity needs and a tripling of basic votes in order to enhance the voice of low-income countries. Furthermore, they called for consideration of a “double majority” rule for all policy decisions taken by the IMF.

While recognizing the enhanced contribution of middle-income countries to IDA through the very substantial increase in transfers from IBRD and IFC, Ministers stressed that such transfers should not in any way be considered as a substitute to the commitments by IDA donors. Ministers reiterated the need for merit and broad geographic representation based selection of the heads of the two institutions.

Ministers agreed that globalization is development challenge of the time and the appropriate frame for reshaping the World Bank’s long-term strategy. Ministers look forward to engaging in the discussions on how to translate the broad strategy that is emerging into a concrete program of action.

With respect to the third issue, ministers observed that the World Bank Group should be structured as a development cooperative, with better coherence and synergies between the different parts of the Group. To support low-income countries and fragile states, Ministers called upon all IDA donors to raise the goal for IDA-15 and upon IFC to expand its support to the private sector in low-income countries especially in sub-Saharan Africa.

On the fourth issue, ministers stressed that any approach to climate change must take into account the fundamental issues of equity on energy access, climate mitigation and climate adaptation by noting that per capita carbon emissions in developing countries are a fifth on average of advanced countries.

Ministers emphasized that energy supply and services is critical for economic growth and improving living standards for all developing countries and noted that developing countries are likely to suffer the earliest and hardest from climate change that appears to some extent unavoidable. They therefore stressed the need to develop and implement an approach that would produce effective and equitable outcomes. Furthermore, innovative and additional financing mechanisms are needed to expand energy supply and access and greater international cooperation to develop and transfer low-cost technologies to developing countries.

9.3.2 Development committee[2] meeting

On their meeting held in Washington DC, on October 21, 2007 to discuss the future strategic direction of the World Bank Group, members welcomed the commitment to develop and refine the strategic framework. They emphasized the importance of efforts to strengthen synergy among the Bank Group institutions and agreed that strengthened support for the inclusion and empowerment of the poorest in development. They also noted equality and women's rights are crucial for sustainable poverty reduction.

The members welcomed the report on the Bank Group's role in Global Public Goods (GPGs) and its emphasis on integrating the GPG agenda into country-owned programs. They stressed the importance of the Bank responding to global challenges in cooperation with other international institutions.

The committee members welcomed the progress made by many low-income countries in strengthening development strategies and implementing policy and institutional reforms, and noted that many countries have enhanced their capacity to absorb larger amounts of aid productively. They stressed the need to sharpen the focus of poverty reduction strategies on stronger, shared, private sector- led growth, to link these strategies better to budgetary frameworks, and to implement them effectively. The members also reaffirmed the importance of the

2 Known formally as the Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries, the Committee was established in 1974.

country-based model, founded on strong country ownership, which is crucial for improving aid effectiveness and harmonization.

They called on donors to meet their respective commitments to scale up aid for development, improve aid predictability and address financing gaps for meeting the MDGs and reiterated their call to those donors who have not done so to make concrete efforts towards the target of 0.7% of gross national income as Official Development Assistance in accordance with their commitments. The members noted that emerging new donors and creditors bring much-needed resources and development knowledge, while underscoring that the effectiveness of these resources will depend on their alignment with country priorities, as well as creditors' commitment to the debt sustainability framework. The members encouraged wider implementation of the Results, Resources, and Partnership approach and underlined the need for a strong IDA 15 replenishment to enable IDA to play its crucial platform role in the evolving aid architecture.

The members noted that global economic growth remains strong and the direct impact of recent financial market turbulence on developing countries has been limited and urged governments to continue implementing policies supporting economic resilience, and urged the Bank and the Fund to support and monitor those efforts. The members recognized the critical importance of energy access for growth and asked the Bank Group to increase its support for access to modern, cost-effective, clean energy, especially among the poorest and in Sub-Saharan Africa.

Bearing in mind the scale of the challenge of addressing the causes and impacts of climate change, the members called on Bank management to develop a strategic framework for Bank Group engagement, including support for developing countries' efforts to adapt to climate change and to achieve low-carbon growth while reducing poverty. In this connection, they urged the Bank Group to enhance cooperation and harmonization with other development partners, based on comparative advantages, and to help catalyze substantial additional resources from both public and private sources, including concessional finance as appropriate (e.g., Global Environment Facility).

The members noted the progress in implementing the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI), and stressed the need for all creditors to participate on an equitable basis, including non-Paris club and commercial creditors. They stressed the importance of providing dollar for dollar compensation for lost credit reflows due to the MDRI and HIPC initiatives, as agreed. The members observed that, improved debt burden indicators notwithstanding, the risk of debt distress in many HIPCs remains a challenge to their long-term debt sustainability. In this regard, they emphasized the importance of sound lending and borrowing decisions guided by the Bank-Fund Joint Debt Sustainability Framework (DSF), and the strengthening of public debt management, for preventing unsustainable accumulation of debt by HIPCs and welcomed the efforts of the OECD Export Credit Group to develop sustainable lending guidelines embodying the DSF.

The members of the committee reiterated their strong support for intensified efforts to agree on an ambitious pro-development Doha Round and stressed the need to integrate trade and competitiveness within national development strategies, while stepping up support for Aid for Trade, as proposed by the Bank and Fund.