

### **INFLATION UPDATER—April 2009**

- Recently released data from Ethiopia's Central Statistical Agency confirm that inflation—which fell to 23.7 percent in March 2009—remains on a clearly downward trend.
- We can now forecast with a fairly high degree of confidence that inflation (on a year-on-year basis) will be just under 5 percent by June 2009, the end of Ethiopia's fiscal year. However, on a year-average basis (comparing average price levels in the last 12 months to those in the prior 12 months), we see inflation remaining at a still high rate of around 37 percent by year-end.
- The latest inflation reading bodes well for the economic and business outlook in the two areas—credit and foreign exchange—where the private sector has been feeling a squeeze for quite some time.

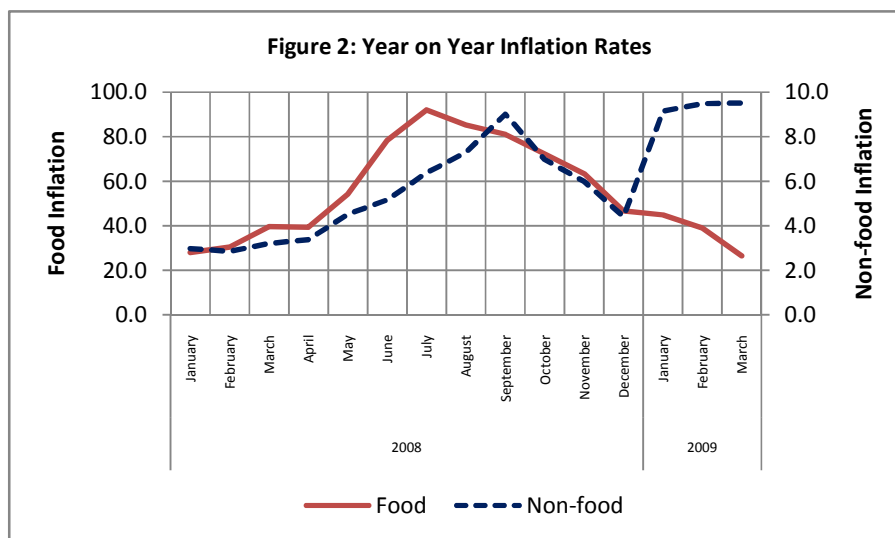
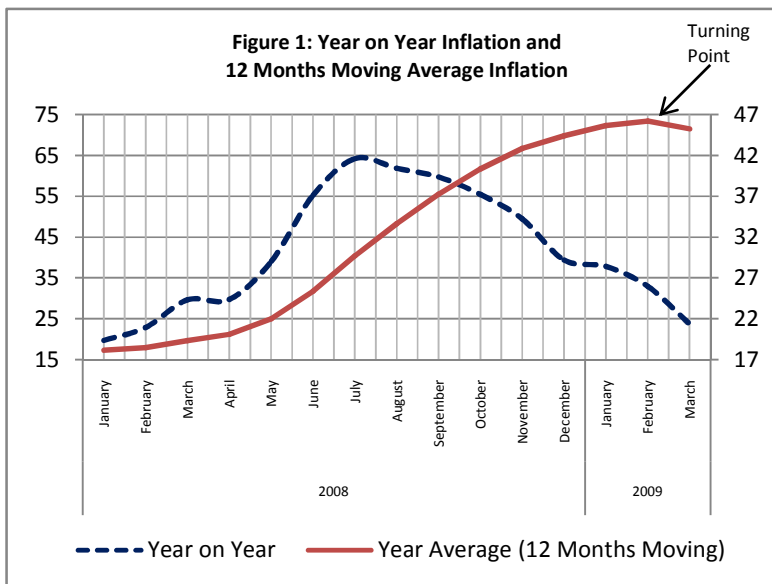
*April 2009*

*Access Capital Research*

The latest inflation data release from Ethiopia’s Central Statistical Agency shows that (year-on-year) inflation has declined to 23.7 percent in March 2009. This measure of inflation is now nearly a third of its peak of 64 percent registered last year and also marks the eight consecutive month of falling year-on-year inflation (Figure 1).<sup>1</sup>

An even more welcome part of the latest data release is that year-average inflation has begun to fall for the first time in some 14 months. Year-average inflation compares average price levels in the most recent 12 months to those in the prior 12 months (and thus rises rather slowly in a period of fast-rising prices while also tending to fall only gradually once prices begin to stabilize). By this measure, Ethiopia’s inflation had been rising continuously since end-2007 (even after other inflation measures had started falling for many months) and reached a peak of 46 in February 2009. For the first time in more than a year, however, year-average inflation fell—to 44 percent—in March 2009. That such a turning point has been registered is significant as it suggests that inflationary pressures are now clearly dissipating.

In terms of its underlying components, the declines in both measures of inflation reflect falling prices in the two largest categories that comprise the consumer price index: food plus “rent, construction materials, and utilities” (Figure 2). The main food price declines occurred for cereals and pulses, both of which are well below their peak levels recorded last year. The overall food price index itself is now down 16 percent from its peak reached in September 2008.



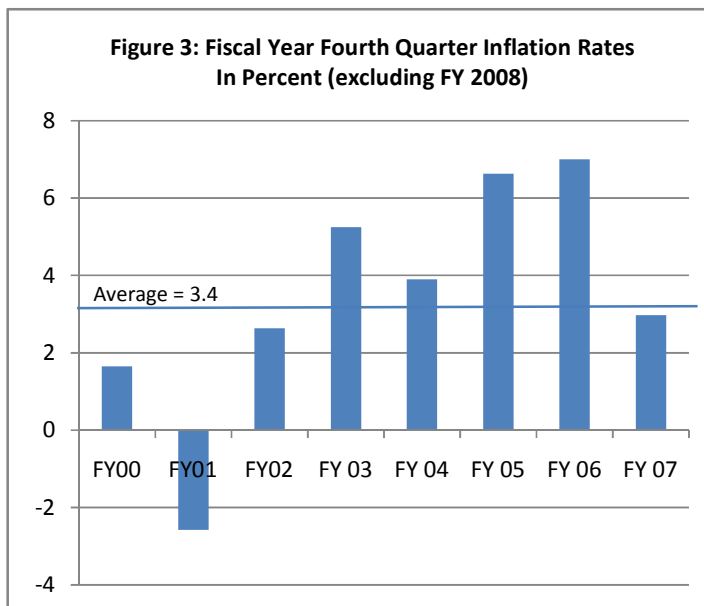
**Falling inflation does not mean an end to the high price levels still straining most consumer incomes.** A reduction in inflation simply means that the *growth rate* of prices is now slowing—but this says nothing of the high price level at which this slowdown is occurring. In fact, Ethiopia’s aggregate price levels are, on average, about double the levels they were in June 2005; when it comes to food prices, current prices are double the levels that they were as recently as June 2006. Given this jump in prices, real incomes have risen by much less than is implied by simple measures of nominal GDP per capita.

<sup>1</sup> The observed decline in inflation from 32.9 to 23.7 percent between February and March 2009 matches almost exactly the projections contained in our published Macroeconomic Handbook some two months ago (see [www.accesscapitalsc.com](http://www.accesscapitalsc.com)).

With respect to the outlook for the coming months, we are now fairly confident that inflation will be just under 5 percent by June 2009 (the end of Ethiopia’s fiscal year).<sup>2</sup> Three alternative approaches for gauging the inflation outlook all suggest broadly the same conclusion:

(i) **Month-on-month inflation remains very subdued**, and rose by only 0.06 percent in March 2009. At an annualized rate, this implies extra inflation of below 1 percent over the course of a year. March 2009 was clearly a very low reading for month-on-month inflation, but even if one considers the average month-on-month inflation recorded since the start of the year (0.4 percent), the implied annualized rate is still just 5 percent. Recent monthly data thus do not point to any notable inflationary impulses.

(ii) **Historical inflation data for the last quarter of the fiscal year** suggest that this is normally a period for relatively low price increases. Looking at the pattern of quarterly inflation over the past decade, we find that average inflation in the period between end-March and end-June is only 3.4 percent (Figure 3), excluding the very special case of 2008.<sup>3</sup> If this historical norm is assumed, Ethiopia’s price index will reach 175.8 at end-June 2009. Given a price index of 166.7 last June, the implied year-on-year rate for end-June 2009 would in this case be only 5.5 percent. Put another way, prices can rise by as much as 4.7 percent in the period between March and June, and this would still allow for inflation to be just 5 percent on a year-on-year basis.



(iii) **Finally, we expect ad hoc factors will help put a lid on prices for this specific year.** Foremost among these is the government’s very recent and very large scale import of wheat, which will have the effect of tempering price increases not just for wheat but also for other cereals that are close substitutes. As food is largest component of the price index (57 percent), this will tend to dominate all other price developments. Second, the global economic environment will continue to be favorable, at least when it comes to the absence of external price pressures. According to the April 2009 IMF World Economic Outlook projections, for example, prices for oil (Ethiopia’s largest import) are expected to be near USD 50 per barrel in the second quarter of 2009, down from USD 121 per barrel in the same period last year; other external prices have also shown significant drops in this period. Finally, on the domestic front, a host of macro-economic factors, including very restrained credit conditions and slowing growth will help hold down prices. Given all these considerations, we expect very modest price increases in the last quarter of the fiscal year and thus forecast year-on-year inflation to fall below 5 percent by June 2009 (Figure 4).

**Inflation trends matter for what they imply about likely developments in other important areas of economic policy, and in this respect, the latest figures bode well for both credit and foreign exchange prospects.** With respect to credit, the latest inflation readings provide the central bank with a much stronger basis for undoing its recent measures aimed at

<sup>2</sup> On a year-average basis, however, inflation will remain at still high level of around 37 percent by June 2009 and is unlikely to reach single-digit levels for at least another year.

<sup>3</sup> The year 2008 is excluded since it represented a very exceptional year that marked the peak of a long run in commodity and other asset prices; such a unusual worldwide spike is not expected to occur again any time soon (see, for example, the IMF’s Spring 2009 World Economic Outlook).

restricting credit availability. In fact, we are now even more convinced than before that a monetary policy reversal is imminent soon after the start of the new fiscal year, in line with the policy easing seen across much of the world. In terms of the foreign exchange outlook, we continue to think that a substantive exchange rate depreciation becomes increasingly more likely as inflation continues to decline, given that the country's hitherto high inflation had been one of the main factors holding back a (much needed) exchange rate adjustment. Both of these anticipated developments, i.e., the loosening of bank credit and a further depreciation of the exchange rate, should go a long way towards easing some of the sharp financial constraints recently faced by large segments of the private business community.

**Figure 4: Consumer Price Index and Access Capital Projections**

Monthly	Consumer Price Index	Month-on-Month Inflation	Year-on-Year Inflation	Year-Average Inflation
Jan 2008	120.2	1.5	19.7	18.1
Feb 2008	125.7	4.6	22.9	18.5
Mar 2008	135.2	7.6	29.6	19.3
Apr 2008	137.2	1.5	29.7	20.1
May 2008	147.8	7.7	39	22.0
Jun 2008	166.7	12.8	55.2	25.4
Jul 2008	179.9	7.9	64.1	29.7
Aug 2008	182.3	1.3	61.8	33.6
Sep 2008	184.1	1.0	59.7	37.2
Oct 2008	182	-1.1	55.4	40.3
Nov 2008	175.1	-3.8	49.4	42.8
Dec 2008	164.9	-5.8	39.3	44.4
Jan 2009	165.6	0.4	37.8	45.6
Feb 2009	167.0	0.8	32.9	46.2
Mar 2009	167.2	0.1	23.7	44.3
<b>Apr 2009</b>	<b>168.9</b>	<b>1.0</b>	<b>23.1</b>	<b>44.2</b>
<b>May 2009</b>	<b>171.4</b>	<b>1.5</b>	<b>16.0</b>	<b>41.8</b>
<b>Jun 2009</b>	<b>174.8</b>	<b>2.0</b>	<b>4.9</b>	<b>36.8</b>

Source: Central Statistical Authority for historical data.

April-June 2009 figures are Access Capital projections.