

**Private Sector's Responses to the Current Global Financial
and Economic Crisis: The Case of Ethiopia**

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**To:
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Contents

- 1. Introduction**
 - 1.1. Background**
 - 1.2. Objectives**
 - 1.3. Methodology and Data Sources**

- 2. The Implications of the Crisis on Ethiopia**
 - 2.1. The recent macroeconomic performance**
 - 2.2. Ethiopia's Integration into the global economy**
 - 2.2.1. Finance**
 - 2.2.2. Trade**
 - 2.2.3. Investment(FDI)**
 - 2.3. Transmission Channels and its Implication on Ethiopia**
 - 2.3.1. Trade**
 - 2.3.2. Investment(FDI)**
 - 2.3.3. Remittance**
 - 2.3.4. Aid and loans**
 - 2.4. Implications and Responses of the Private Sector**

- 3. Crisis Cushioning Policy Measures**
 - 3.1. The Global Efforts**
 - 3.2. Policy Measures by Ethiopia**
 - 3.2.1. Measures taken**
 - 3.2.2. Measures recommended**

- 4. Conclusions**

Chapter I

1. Introduction

1.1. Background

The global financial system has witnessed rapid growth and substantial structural change during the last ten years leading to globalization of financial markets. The integration of financial markets has accentuated the rapid flow of capital across borders as well as magnified the contagious effects of financial crisis with wide implications for transmission of financial policies on the domestic economy and internationally. The world is currently facing the most severe financial and economic crisis. The financial crisis was generated by turmoil in the real estate market and triggered initially by the sub-prime mortgage crisis in the United States. It occurred just after the food crisis and the significant spike in energy prices in the world.

The crisis is having repercussions on economies throughout the world and is likely to be the most severe global crisis since the Great Depression of the 1930s.

According to William E. James et. al. (2008), the financial problems of the US have their roots in monetary and fiscal policies, but are also a result of the irresponsible behavior of private lenders and borrowers; and the excessive risks that were taken fueled by cheap and plentiful money, which made possible a decade-long housing boom. The proximate cause of the downturn in the US economy is the declining prices of housing, the major asset of US households. However, the downturn in housing prices alone cannot explain the recent turmoil in the financial markets as housing prices have been falling for almost 2 years. Fundamental structural problems are apparent. "Twin deficits" have characterized the US economy after 2001. The current account deficit reflects the imbalance between US national saving and investment (Cooper 2005), which takes into account both private and government saving and investment balances. The US has experienced a structural imbalance between savings and investment that has led to a persistent current account deficit.

Mortgage lending grew alongside a long boom in US housing prices that seemed never ending. The Case-Shiller Composite Index of housing prices rose continuously for 38

straight quarters beginning in 1997 and lasting into the first half of 2006 before it finally began to slide. Growth in housing prices was such that lenders began to take untoward risks in providing mortgage credit to “sub-primes”—borrowers who had no collateral, made no down payments, had no credit history (or had bad credit history), and who initially paid only interest but not principal at low initial “teaser” interest rates.

The two mortgage loan guarantee giants, Fannie Mae and Freddie Mac, participated actively in the secondary market for housing-backed securities and helped primary lenders to make mortgage credit available to households and individuals who would not otherwise qualify for home loans¹. Both of these government-sponsored enterprises (GSEs) were pushed to help primary lenders expand this risky type of lending, and this contributed to the massive expansion of their portfolios to over US\$5 trillion or nearly half the value of all US housing mortgages. The net income of the GSEs plunged after Q2 2007 and with these losses their share prices collapsed and all but wiped out their capital, forcing the US government to step in and take them over on 7 September 2008.

The “securitized” mortgage-backed assets were moved onto the books of separate vehicles (structured investment vehicles or SIVs and collateralized debt obligations or CDOs) and artificially made the balance sheets of the banks appear more profitable than they really were. What emerged was a shadow banking sector that was riddled with nonperforming assets of very uncertain valuation. Insuring these assets against default risk was undertaken privately through CDS by which large insurers such as American International Group (AIG) provided guarantees that ultimately proved to be very costly indeed.

The emergence of the CDS market as insurance against default by the highly leveraged investment banks (leveraging against capital was often in excess of 30-1 in major US investment banks) provided only the illusion of risk dispersion. As the giant AIG found out once Lehman Brothers went bust, the CDS calls put even insurance giants at the edge

¹ Legislated targets for expanding GSE support for housing loans to low-income and disadvantaged individuals and households were ratcheted up in recent years (Roberts 2008). The failure of the regulators of the GSEs to recognize that a housing bubble was being supported by increasingly risky behavior is explained in detail in Shiller (2008) and Smick (2008).

of bankruptcy. Valuation problems are rife and the search for the bottom of the housing and stock markets still has a way to go. Confidence has evaporated and credit lines between banks and between firms in real economy sectors and nonbank financial institutions are frozen. No one wants to lend.

The rapidity with which the US subprime crisis spread across the Atlantic was related to the perception that many investors there had exposure to the toxic assets derived from the US mortgage mess. This perception has proven to be accurate. For example, the Dexia Group (a French-Belgian lender incorporated in Luxembourg) had exposure to the subprime residential mortgage backed securities through its affiliate Financial Security Assurance, Inc., which had to write down losses of over US\$750 million in the first half of 2008, and saw its credit rating downgraded from AAA+ to AAA- and then to AA-. Shortly thereafter the governments of Belgium, France, and Luxembourg had to jointly inject US\$9 billion into Dexia after its shares plunged by 30%. Fears of losses from exposure to the subprime-backed derivatives through the investments by big European banks in failed US investment banks such as Bear Stearns and Lehman Brothers are palpable.

It was seen that the subprime crisis has already spread across the Atlantic to many European countries. The general perception is that so far Asian financial institutions and financial systems as a whole have been largely unscathed by the global credit crisis. The underlying reason behind Asia's relative immunity is that the region's financial institutions, unlike their counterparts in Europe, have only limited exposure to subprime and related products, the so-called toxic assets. Nevertheless, the global financial turmoil is far from over, as the dramatic events in the fall of 2008 made abundantly clear. It remains to be seen whether Asian financial systems will remain healthy as the global crisis unfolds.

The Asian 1997–1998 post crisis reform and restructuring efforts have improved the soundness and efficiency of the region's financial institutions but they still lag far behind their counterparts in industrialized countries. In a fundamental sense the relative backwardness of Asian financial systems has turned out to be a blessing in disguise.

Their backwardness prevented Asian lenders from moving into complex and sophisticated financial products that lie at the heart of the current financial turmoil. However, notwithstanding its accidental benefits for Asia at the present, financial underdevelopment is more generally a cause of financial instability and fragility.

There are various channels through which the global financial chaos could be transmitted. The most direct and core transmission channels are through banks and short-term credit markets. Banks may have either direct exposure to toxic assets or indirect exposure through investments in foreign financial institutions with large exposure to toxic assets, e.g., in Lehman Brothers. Furthermore, the seizing up of global cross-border interbank markets will raise the cost of funding for banks relying on those markets. At the level of individual banks, these direct transmission channels have materialized to varying to varying degrees.

In Asian countries the banking system as a whole seems to have . system as a whole seems to have withstood the shock so far, which goes a long way toward explaining why the global crisis has not spread to the region. However, the region has not completely escaped the fall-out from the global financial chaos because two more peripheral and indirect transmission channels—equity and US dollar debt markets—have materialized to a more significant degree and uniformly across Asian countries.

The impacts of the turmoil on the real sector of globe has already begun to feel the pinch. While the Asian Development Outlook 2008 Update (ADB 2008b) anticipated a deceleration in industrial countries' economic expansion that would extend through 2009, a recession is now already under way in Japan, UK, US, and euro zone. Global demand is being crimped, already translating to slower growth in overall trade volumes.

The exposure of some regional economies is higher than others. Those with weak macroeconomic fundamentals, i.e., facing higher inflation, faster credit growth, fiscal and current account deficits, and higher external debt, may have less capacity to withstand the adverse effects if the turmoil is to worsen.

The extent of the damage done by the crisis is so significant. As of May 2008, total reported write-down and credit losses of the world's 100 biggest banks and securities amounted to US\$379 billion. Many banks across the industrialized world have gone bankrupt.

The OECD's latest Economic Outlook shows that the world economy is now in recession. Projections point to a protracted downturn in the OECD, with GDP likely to decline by at least 1/3 of a percent in 2009. In other parts of the world, similar slowdowns are taking place. According to IMF's recent projection, the global growth is projected to slow by----percentage point in 2009.

There remains a large degree of uncertainty about the depth and duration of the financial crisis, which has been the prime driver of the downturn. The spillover to the real economy has already translated into rising unemployment in many countries and the collapse of commodity prices. The effect has also been felt in LDCs, which has nothing to do with causing the problem.

Thus, trying to understand the root causes, as well as the impacts of the crisis on one's country is essential for taking mitigating policy measures that will help to calm the crisis and avoid similar shocks in the future.

1.2. Objectives:-

- Provide a brief background about the global financial crisis;
- Provide a qualitative and quantitative assessment of the impact of the crisis on the Ethiopian economy, giving emphasis to the implications for private sector and their responses; and
- Suggest policy measures that help cushion the impacts of the crisis.

1.3. Methodology and Data Sources

It is difficult to carry out a simulation exercise that help project the possible impacts of the global economic recession on Ethiopia's key macroeconomic variables due to absence of an econometric model.

However, towards the achievement of the stipulated objectives, a combination of different methods is employed. Which includes, review of the empirical literatures on the crisis; analysis of information obtained from secondary sources such as NBE, MOFED, CSA ECA and international sources; conducting of small scale survey to collect primary data by conducting an interview questionnaires on judgmentally sampled enterprises believed to be affected in the export sector and industries that are dependent upon imported raw materials, and review of the various NBE and MOTI amendments to the external trade directives in response to mitigating the crisis.

In trying to separately show the impacts of the crisis on the country, September 2008 is taken as a dividing line for the pre- and-post crisis situations. The collected information is analyzed descriptively. Results of the analysis are presented in tabular and graphic forms with due discussions thereon.

Chapter II

2. The Implications of the Crisis on Ethiopia.

2.1 The Recent Macroeconomic Performances

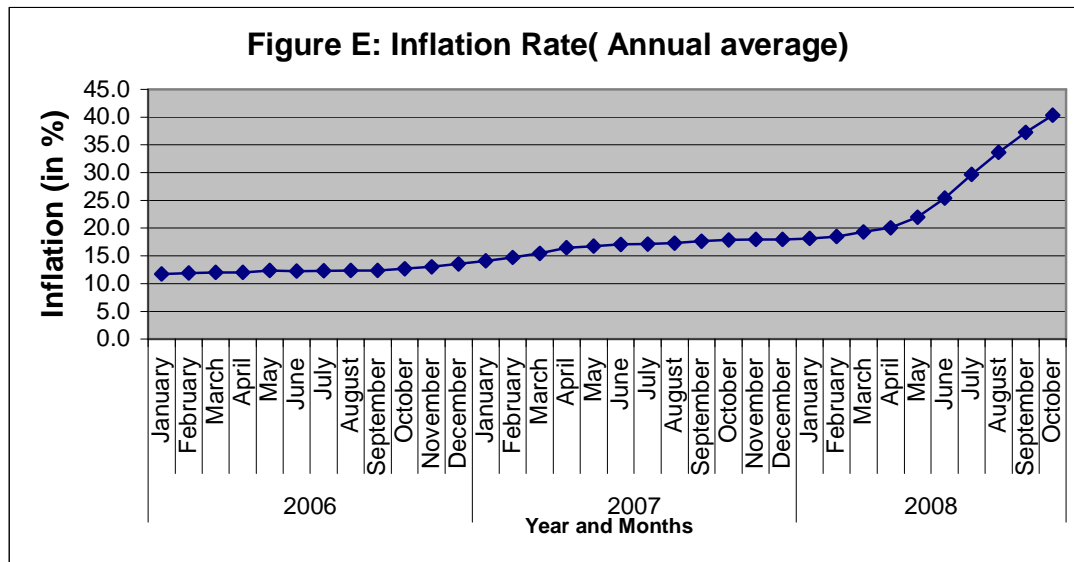
None of the standard fundamentals, such as GDP growth, gave an indication of the problems that were to come to the country in the current year(2008)- may be gathering momentum for year 2009 as predicted by IMF. in 2007/08, the country registered GDP growth rates of 11.2 per cent per slightly lower than the rate registered in the preceding two years(2005/6 and 2006/7) (Table 2.1).

The current crisis has in fact confirmed the proposition that the slowdown in global growth has negatively affected the growth performance of the developing countries. . IMF projections have indicated a substantial fall in the growth rates of developing countries from 6.25 per cent in 2008 to 3.25 per cent in 2009 that of Ethiopia from 11.2 down to 6.5 percent (Dwight V. 2009).

The country has been Generally pursuing expansionary fiscal and monetary policies, which took the fiscal deficits above 5 % of GDP in recent years and more than 20 percent increase in money supply. These two policies are believed to have played significant role for the skyrocketing inflation rate in the country. Cognizant of the damaging effects of these policies on the stability of macro economy, the government of Ethiopia and IMF agreed on austere macroeconomic package which includes tight fiscal policy, with government domestic borrowing targeted at zero-down from 2.7 percent of GDP in the preceding fiscal year(2007/08). Tight monetary policy which limit broad money growth to less than 20 percent down from 23 percent in the preceding fiscal year.

Inflation has remained the prime challenge facing the country. Since 2004/05, the country has been experiencing double-digit inflation. The Inflation rate has increased from around 10 percent in January 2006 to above 40 percent in October 2008(Figure E). The rate is so prohibitive given the low income base of the population. It is increasing awkwardly in the wake of declining global commodity prices; for instance, fuel comes off USD 147 per

barrel, the maximum before crisis, to around USD 40 per barrel in 2008 depicting a 267.5 percent decline due to the slowdown in the global demand. This suggests that the deriving force behind the rising imported inflation to be the shortage of foreign exchange to import the required quantity of goods rather than the pas through effects of the global commodity price and the exchange rate.



Source: CSA

Despite the huge infrastructure defect that need be financed, the country has been keeping a very low rates of saving- averaging at about 7-10 per cent of GDP. However, investment has maintained in the range of 20-25 per cent of GDP thereby requiring foreign financing of the gap(Table2.1). In deed, the lion’s share of the investment has been on infrastructure and human capital development which, in turn, are believed to increase the country’s productive capacity in the future.

In the early phases the unprecedented increase in the price of oil and then food, had significant negative impacts on the balance of payments of most countries. On top of this the current crisis has reduced export earning and made import cheaper thereby making the trade balance of Ethiopia to deteriorate considerably. The trade bale has deteriorated from a deficit of 4’4 billion USD in 2006 to 5.0 Bn in 2007 and further to 7.4 in 2008 there by putting maximum pressure on the international reserve of the country which

come down to 1.2 months of import (the standard benchmark is 3 months of imports of goods and services of next year). This pressure in turn led to the depreciation of the Birr by 10 percentage point and is yet inviting further depreciation/devaluation.

Table 2.1: Macroeconomic indicators

Description	2004/05	2005/06	2006/07	2007/08	2008/09, Forecast
GDP growth rate, real			11.5	11.6	11.2
% Share in GDP					
Investment	20.5	19.8	24.8	21.2	20.3
(Export plus Import) /GDP (Measure of openness)	50.1	47.7	44.8	42.7	39.4
Trade Balance, in Bn USD		4.4	5.0	7.4	

Source: MOFED, NBE and author's computation

2.2 Ethiopia's Integration into the Global Economy

In order to examine as to whether the global crisis impacted Ethiopia or not one is required to start with portraying the degree to which the country is integrated into the global economy. The integration can many forms including mainly finance, trade and the flow in investment(FDI).

2.2.1 Finance

In a fast globalizing world, financial integration is expanding and WTO is working towards its materialization pressurizing countries to liberalize their financial sectors. The most often mentioned source of financial instability are foreign ownership of domestic banks and domestic banks' investing in foreign banks.

However financial institutions Ethiopia are fairly insulated from the global financial crisis for they are not the holders of the toxic mortgage backed securities which have depreciated in value. Foreign banks do not have branches, or even stand-alone subsidiaries, in Ethiopia. The relationship between foreign and domestic banks is only that of the correspondent banking relationships for facilitating day-to-day trading transactions.

These all shows that Ethiopia is not integrated the least into the global financial market and hence the crisis does not have a direct effect on the banking industry. The less integration is due to capital account control and underdevelopment of the financial sector. In fundamental sense, the relative backwardness of Ethiopian financial system has turned out to be a blessing in disguise. However not withstanding its accidental benefit for Ethiopia at the present, financial underdevelopment is more generally a cause of financial instability and fragility. underdeveloped financial systems are incapable of directing capital to its most productive uses.

2.2.2 Trade

No country can fully close itself and survive on its own. A country imports commodities that it does not produce at home and export what it produces in excess. Thus, most countries including Ethiopia are integrated into the rest of the world through trade, though the degree differs. The degree of a country's integration through trade can be measured by openness index. Openness is measured, among other variable , by export plus import to GDP ratio, the larger the ratio the more open its economy is and vice versa .

In this regard, Ethiopia openness range between 50 to 38 percent which is far higher than the openness index witnessed by the US (Table 2.1). This ratio confirms that Ethiopia is highly integrated into the global economy, especially the industrialized and emerging economies and hence external trade is the main transmission channel of the global economic recession which is caused by the global financial crisis.

For the country, commodities make up a considerable proportion of the export basket and, are a significant source of foreign exchange, income and employment generation. Hence, commodity price patterns over the next year (or more) are expected to cause the recent engines of growth(export) to come to a standstill.

2.2.3 Investment(FDI)

Another integration channel is the flow of capital from a relatively abundant country to scarce one. In this regard, Ethiopia has been trying to attract FDI by opening its door and providing incentive packages. As a result, the flow of foreign capital has been increasing these days. FDI which has been 521.2 million US Dollars in 2006/07 increased to 814.6 million US Dollars in 2007/08 thereby indicating its growing significance in bringing foreign capital and introducing advanced technology that enhances the technological capability of the country². Available evidences suggest that Ethiopia has started attracting foreign investors. This move verifies the country's integration to the rest of the world in terms of capital inflow though not as critical as that of the emerging economies.

2.3 Transmission Channels and its Implication on Ethiopia

The main channels through which impacts on to Ethiopia include trade (falling export revenues), reduction in official aid and loans, cut in FDI flow investment and reduction in remittances.

While qualitatively it might be possible to delineate the different channels through which the effect of the crisis pass on to Ethiopia, it is difficult to provide an accurate quantitative measure of the effect of the crisis. This is not only because the crisis is still unfolding, and difficulty in obtaining current data but mainly because of the traditional problem of providing a precise measure of the counterfactual situation— in this case, measuring what would have been the value of the different economic indicators in the absence of the crisis. Nonetheless attempt is made here to make trend analysis of the major variables which carries the impact home.

2.3.1 Trade Channel

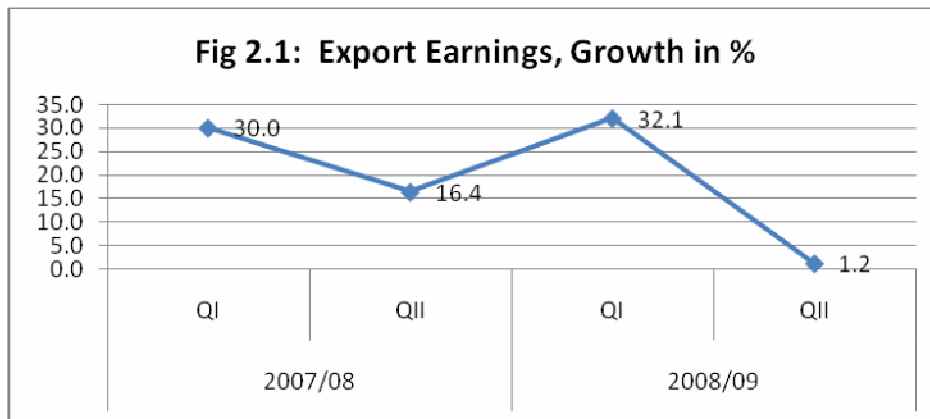
It is apparent that the crisis had a negative impact on export prices and trade volumes. The economic recession in the industrialized economies has led to a contraction in their import demand, thereby discouraging exports from the rest of the world including

² Data from National Bank of Ethiopia(NBE), Quarterly Report.

Ethiopia. In the next section, we will try to see impacts on the general exports and the major export commodities

i) Export Earnings

While the growth in export earning in the first quarter of 2008/09 (June-August 2008) shows 32.1 percentage increase over same quarter the preceding fiscal year, the growth in export earnings in the second quarter of 2008/09(September- December 2008) has depicted a mere 1.2 percentage point increase over same period the preceding year(Figure 2.1). this shows the starting of the growth reducing effect of the global recession since September 2008.

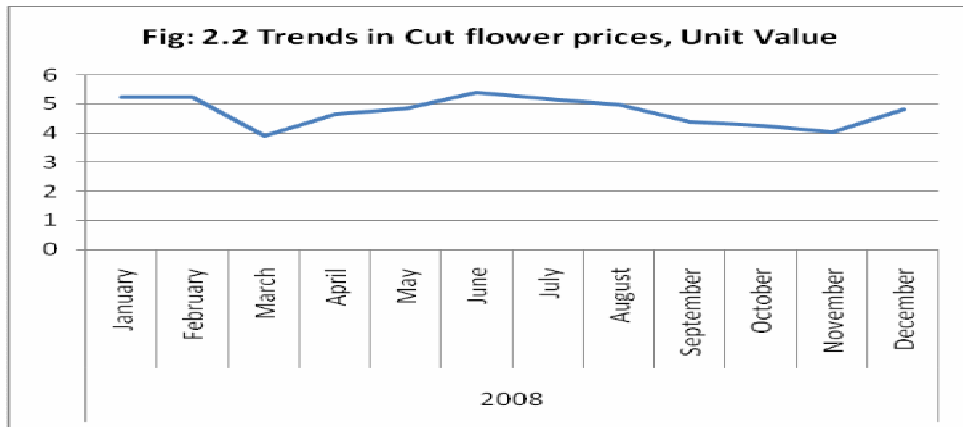


Source:NBE

The decline in the growth rate could well be attributable to the decline in both international commodity prices and the reduction in demand(volume) effects. In fact the decline in the prices our major export commodities; namely, coffee and cut flower are well documented.

According to International Coffee Organization, International coffee price has increased from 86.04 US cents per lb in June 2006 to reach 138.82 Cents per lb in February 2008 but thereafter declined to 103.07 in December 2008 thereby indicating 25.8 percentage point decline from February 2008 to December 2008. The decline in price can be attributable to the decline in world (income) demand which in turn is due to the global

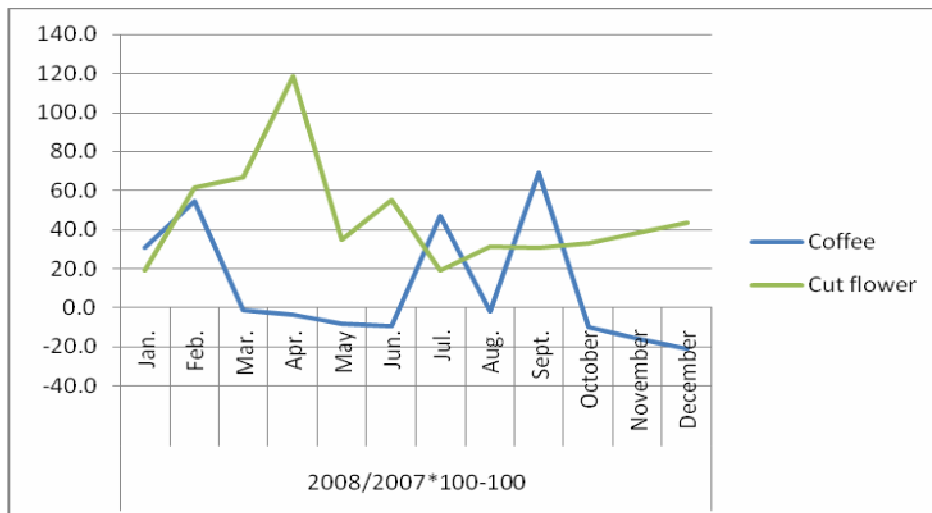
slow down emanating from financial crisis. the decline in cut flower price can be inferred from fig where a consistent volume of export fetches only reduced earnings following



Source: Data from NBE and Author's calculation

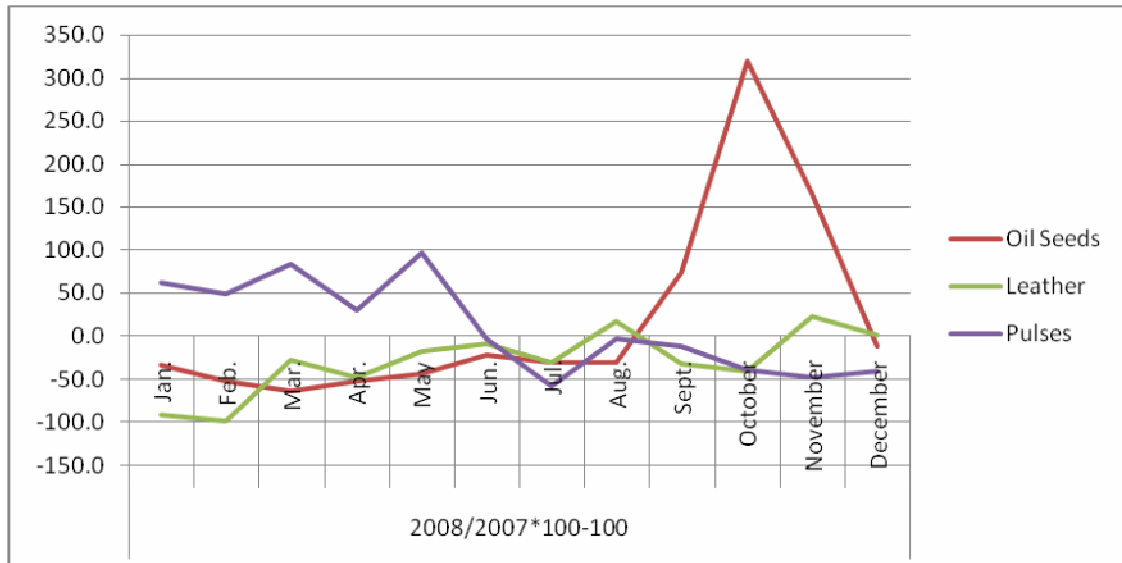
In terms of the month to month computed growth in the volume of exports, the month starting October 2008 has shown an over all decline compared with same month preceding years, for coffee, pulses and oil seeds while that of cut flower is an increase (fig 2.3 and fig 2.4)

Fig 2.3: trends in the growth in the volume of coffee and cut flower exports



Source: NBE

Fig: 2.4 Trends in the volume of oilseeds, leather and pulses exports



Source: NBE

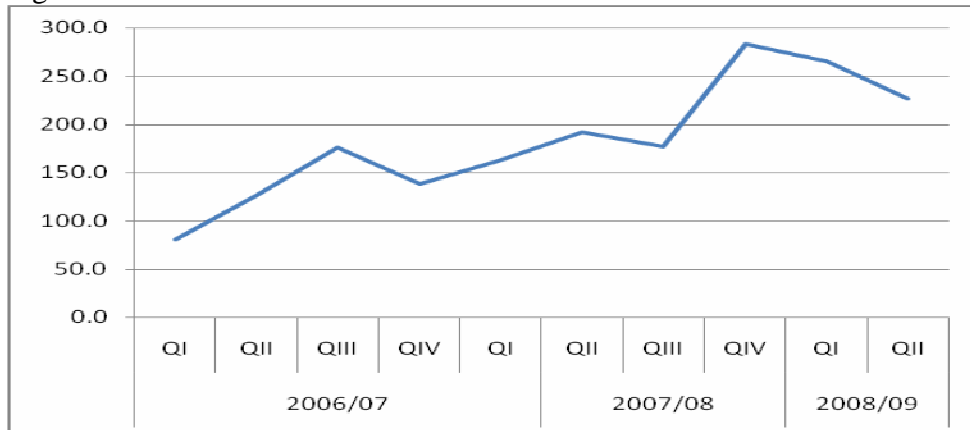
These all leads to the decline in foreign exchange earnings which translate it self to the depletion in foreign reserve unless matched by a proportionate decline in imports. On the other hand a huge fall in international commodities prices will have the tendency to raise the demand for import thereby widening the trade balance. In sum all these taken together will make the country vulnerable in the year ahead.

2.3.2 Flow of Investment(FDI)

It is also likely that the tightening of international financial conditions will have an adverse effect on inflows of foreign direct investment (FDI), which is an important source of resources for some countries in recent years.

Although higher than the flow in similar quarters in the preceding two years, expectedly, the flow of FDI started to trend downwards starting from the first quarter of 2008/09(from July 2008)thereby verifying the FDI dampening power of the international financial crisis(fig 2.5).

Fig: 2.5 Flow FDI



Source: NBE

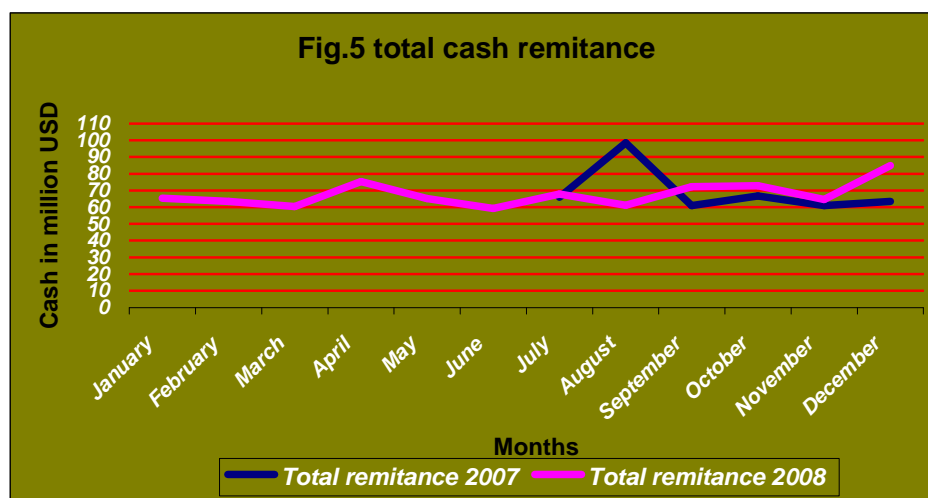
2.3.3 Remittance

The weaker job market in developed economies will have an adverse effect on the remittances that emigrant workers send back to their families in their home country. With respect to remittances, the impact would most likely be negative. However, the likely impact would be so little, because of low skills levels of the majority of Ethiopian and are less likely to be unemployed in this crisis.

In the absence of data, remittances that find their way into the country through illegal channels are estimate to equal the legal amount. At times when the parallel market premium become so lucrative, clearly important amount of foreign currency is expected to be channeled into the market.

The total cash remittance collected through the legal channels has remained in the range of 60 to 80 million USD per month through out 2008, except in December when it jumped to 84.9 million US Dollars (Fig: 5). This runs contrary to the expected decline in remittance income from the rest of the world.

In fact, the remittance to total beneficiary ratio is estimated at 1.14 thousand USD per year. This indicates the smallness of the amount of remittance send per month for a beneficiary- about 100 USD. This amount is not big deal to earn by a Diaspora working in industrialized countries. On top of this, due to the culture of sharing what one gets, most Ethiopian living abroad has been sending to parents' and relative from the unemployment benefits.



Source: NBE

2.3.4 Flow of Aid and loans

Generally, the crisis is assumed to reduce aid and loans that flow to developing countries since it highly affected global donors and creditors and as a result they better resort giving priority to their own country rather than other countries, like Ethiopia.

In fact, foreign aids and loans play important role in financing public expenditures, mostly in developing poverty reducing infrastructures. In our case foreign aid and loans constitute for about 24.6 percent of the capital outlay of the country and hence a decline in aid and loans will reduce public sector investment thereby retarding the poverty reduction efforts of the country and MDGs achievement (Table 2.6).

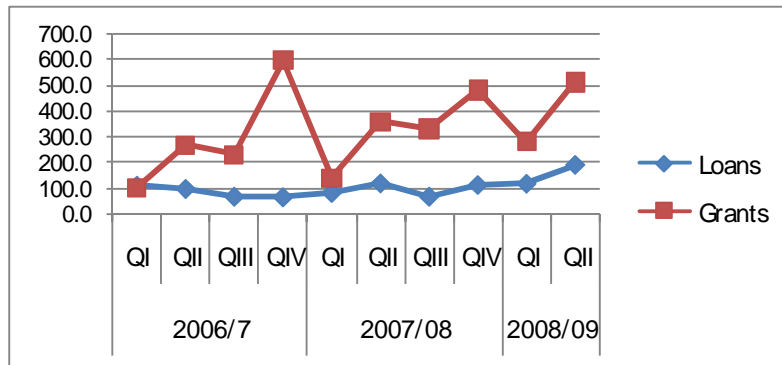
Table 2.6 External Aid and loans and their share in capital outlay

	2004/05	2005/06	2006/07	2007/08
Capital outlay, in Mn Birr	11343	14042	18398	24121
External Aid, in Mn Birr	1513	2196	3081	4034
External loans, n Mn Birr	1454	1061	1484	1810
Share (in %)				
External Aid	13.3	15.6	16.7	16.7
External loans	12.8	7.6	8.1	7.5
Total External Finance	26.2	23.2	24.8	24.2

Source: MOFED and author's calculation

Available information depicts as foreign loans and grants keep on trending up wards from the first quarter which is contrary to the expectation(Fig 6). Moreover since IMF has labeled Ethiopia as the most vulnerable country, it has emergency fund facility. On this base, one can safely conclude that the global financial crisis's effects on our major donors did no lead them to reduce the loans and grants they have been extending to Ethiopia.

Fig: 6 Trends in the flow of loans and grants



Source: National Bank of Ethiopia(NBE)

According to the exercise undertaken by IMF, the country's vulnerability to trade, FDI and remittance to be categorized as medium while that of reduction in aid to be high. After weighting all the four variables, the Fund has come up with a total vulnerability index that labels the country at high ,one among the 9 highly vulnerable sub Saharan African countries(table 7).

Table 7: Vulnerability to Financial and Economic Shocks

Country/ Region	Vulnerability Ratings				Total Vulnerability (Four indicators combined)
	Trade	FDI	Aid	Remittance	
Ethiopia	M	M	H	M	H
SSA	M	L	M	M	9H 24M 3L

Note: H- High, M- Medium and L- Low

Source: WEO database and Fund staff Calculations

Chapter III

3. Implications on and Responses of the Private Sector

3.1. Implications of the Crisis on the Private Sector

3.1.1. Private Banks

3.1.1.1. Implications

Developing countries were thought unlikely to be severely affected because of their less integration into global financial markets. Expectedly, Ethiopian banks and financial institutions have not exposed to toxic assets.

Even though direct exposure is minimal, the country may suffer from substantial indirect exposure if Ethiopian banks have sizable exposures to major US and European financial firms that hold significant amounts of toxic assets. But that is not the case here.

The spillover of the global financial crisis to the real economies of the country will adversely affect Ethiopian export and growth performance to some extent. Banking is a highly pro-cyclical industry that performs well during booms and poorly during recessions. It is the second generation of the effects of the global finance that affects the banking sector. When export is affected the banks lending to exporters will decline and hence the income banks get there from will be reduced.

According to information from private banks, they are feeling the pinch of the global financial and economic crisis through its effects in reducing export demand and the decline in price of export commodities. According to the information, the crisis resulted in shortage of foreign exchange in banks. Moreover interbank forex auction that has been supplying forex for the auction has stopped. As a result, the activities of the international banking transaction of the banks has reduced significantly. The income generated from this transaction usually constitute a significant share of banks' revenue (estimated at about 40 % of the total bank revenue). These incomes include, commission charges on LC processing, premium on foreign exchange purchase and sales, and interest on advances made for importers and exporters.

The other factor reducing the foreign exchange that banks get is , the significant increase in the parallel market rate for foreign currency which happened to more than 12 percent. As a result, private hard currency holders that used to exchange at banks are attracted to the parallel market.

Although the domestic banking industry's correspondent banks that operates through out the industrialized countries which serve as our export destination and import origin are some how affected, it did not passed to domestic banks. In fact, domestic banks keep negligible deposits in their correspondent banks abroad so as to finance imports of clients.

3.1.1.2 Responses

Since the direct impact on the industry is negligible, no measures taken except removing commission charge on remittance income so as to encourage diasporas to use the banking channel to send hard currency

3.1.2 Export

3.1.2.1 implications

As attempted to show in section 2, merchandize export earnings of the country(90 percent private sector's share) started manifesting a declining trend since September 2008 in tandem with the global recession. The resulting decline is due to the interplay of both volume and international price.

Since over 90 percent of the country's export emanates from the private sector, proportional amount of impact fall on the private sector. The impacts are reduction in revenue and incurring of losses and closure of some export firms. As a result of exporters' reluctance to sell coffee at loss internationally , government intervened and jailed 90 coffee exporters by confiscating over 70 thousand tons of coffee from private exporters. This led to the closure of significant coffee exporting firms and layoffs workers in the coffee export industry.

3.1.1.2 Responses:

Due to the interplay of high domestic inflation and reduced international price, the domestic price of most exportable items happened to be higher than the price that export fetched. As a result many export items are directed to domestic market – coffee is the case in point.

In some products, e.g., cut flower the international price happened to lower below the cost of production thereby bringing grower to their knees and leading to the closure of flower farms.

The low international demand and hence price compelled the coffee exporters to reduce the volume of coffee they buy from coffee suppliers who collect from coffee growers in the different coffee growing part of the country. And exporters choose to keep stock of the product expecting improvement in international coffee price.

3.1.2. Importers

a) Implications

According to information from national bank of Ethiopia (NBE), mainly due to foreign exchange supply constraints, the inter-bank foreign exchange market was brought to standstill from December 2007 till now.

These day, owing to the difficulty to get access to foreign currency banks have resorted to the rationing of forex for importers(with reduced size and longer waiting period). As a result, many importers cannot import the commodity they want by the season they want and as a result the quantity of importers import declined and is imported into the country the other season.

The reduced access to foreign currency has resulted reduced import which in turn resulted in an increase in the prices of import commodities of durable and non durable commodities domestically. This is quite contrary to the drastic decline witnessed in the international commodity prices.

3.3 Domestic Manufacturing Industries

a) Implications

Domestic manufacturing industries are affected through two directions. One through the foreign exchange shortage and hence their inability to import raw materials that they need for their operations and the other is through the decline in international commodity prices making them face stiff competition from cheaper imports.

Although obtaining consolidated information is difficult and time consuming, and the nature data lag, discussions made with the manufacturing association indicated that the crisis has affected the private manufacturing industries. According to the discussion, a number of private manufacturing industries has disclosed the problem they have stated facing in terms of access to foreign exchange for raw materials import and their probable halting of production activity if the situation continue.

These all situations have reduced the total production and value added of the sector and resulted loss in revenue and profit of the sector and has impacted other domestic industries and sector with which they have close in put out put linkages.

b) Responses

Some of the manufacturing industries has discontinued production for a while till they get foreign exchange that enable them to import the necessary raw materials for the production process. Coca Cola factory is the case in point. Other factories are obliged to operate under their capacity thereby reducing the number of workers, especially temporary workers.

3.3.4 Real Estate industry

a) Implications

According to information from real estate companies, the crisis has worked in affecting their business so significantly. Since most clients of real estate companies here in the country are Ethiopian living industrialized countries where the crisis has huge impact, they are also affected. Delayance in installment payments has been

witnessed since the very recently, and even some has totally discontinued purchasing contract.

Moreover, the number of new clients that demand for houses in the real estate has reduced significantly from the recent from the trend before the crisis. Besides, attempts of selling houses owned by Diaspora is witnessed in the city due their plan since the price of house in the industrialized countries has highly decline. This situation was able somehow bring down the prices of real estate in the country thesedays compared to the preceding year.

b) Responses:

Reduced construction activities and consequently reduce the employment in the industry, especially temporary ones.

4. Impact Cushioning Policy Measures

4.1. Global level

- interest rate cuts and liquidity injections by Central Banks;
- lending guarantees by Governments to restore liquidity, and reviving the ailing banking system through recapitalization and strengthening of supervision;
- bank deposit guarantees,
- Fiscal Stimulus packages to shore the economy out of recession--- stimulating aggregate demand

4.2. Ethiopia

4.3. Measures taken

- Exchange rate adjustment by 10 percentage points;
- Elimination of commission on foreign currency transfer to encourage private transfer
- Re-introduction of current account control, including the denying of foreign exchange for some purpose e.g. studies abroad,

4.4. Measures recommended

- Government should give priority in the foreign exchange allocation to critical sectors of the economy
- Design a short, medium and long run strategy to mitigate the impacts of such on the country;
- Address the affected sectors through public safety net program,
- Address inflation problem which is directing export commodities into the domestic market and is eroding the competitiveness of the economy especially the export sector
- The nominal and real exchange rate depreciation may help to limit the negative impacts from the demand slowdown and improve the country's competitiveness. Thus, further exchange rate adjustment to the extent that enable it to improve the competitiveness of export and make import expensive and hence improve the worsening balance of payment of the country.
- Introduce a price Support scheme in case the international price fall below the cost of production of critical export items, e.g. coffee

5. Conclusions

The unfolding financial and economic crisis has impacted the world severely. As a result the global economy get into recession. The recession , in turn slowed world demand(income) for commodities and depressed commodities prices .

The financial and then the economic crisis has started impacting the Ethiopian economy. the impact is not direct by affecting the domestic financial institutions but indirectly through its effect on the real economy. The impact passes on through the trade, remittance and FDI flow among other channels. Clearly, the capital account in Ethiopia is not liberalized and hence there is direct effect on the financial sector of the country.

The export sector of the country has starting feeling the brunt of the crisis due to the decline in world demand for export commodities and the consequent decline in its prices. These situation has reduced export earnings of the country from its export commodities thereby constraining the essential import financing capacity of the country.

The shortage of foreign exchange and the inability to access foreign exchange is affecting the private manufacturing industries thereby compelling some to discontinue production till they get the currency and some others to operate under

their capacity. Employment reduction, especially temporary, is witnessed in some sectors an able to get the foreign they require.

The trade balance of the country has deteriorated further. Since the foreign exchange generation came under pressure, imports has been financed by reserve drawdown. As a result, the international reserve has reached at a the lowest level of 1.2 month as at end of December 2008, which is far lower than the standard minimum benchmark of 3 months of imports of goods and services of next year. This situation has led IMF to categories the country among the most vulnerable one and made it eligible for the its Shock Facility.

As far as the September- December 2008 statistical information is concerned, the witnessed impact of the crisis is minimal but has the tendency of increasing impact in the months since then. This is mainly due to the lag nature of the incidence of impacts. According to IMF estimate, a 1 percentage point reduction in the global economy will reduce SSA countries growth by 0.5 percent (0.2 percent contemporaneously and 0.3 percent next year). Thus, the greater proportion of the impacts of the global financial and economic crisis are expected to land in 2009.

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