Ethiopian TVET-System

Basic Account Works
Level-II

Based on August 2012GC Occupational standard

Module Title: Developing Understanding of the Ethiopian Financial System and Markets

TTLM Code: :EIS BAW2 0919TTLM 0919v1

This module includes the following Learning Guides

LG20:Describe what is meant by the Ethiopian financial markets

LG Code: EIS BAW2 M06 LO1-LG-20

LG21:Explain the function and role of the National Bank of Ethiopia (NBE)

LG Code: EIS BAW2 M06 LO2-LG-21

LG22:Explain Ethiopia's monetary system

LG Code : EIS BAW2 M06 LO3-LG-22

LG23Explain the key factors that influence the Ethiopian economy

LG Code: EIS BAW2 M06 LO4-LG-23

LG24:Describe the role of regulators

LG Code: EIS BAW2 M06 LO5-LG-24

Instruction Sheet	LG20:Describe what is meant by the Ethiopian financial markets

This learning guide is developed to provide you the necessary information regarding the following content coverage and topics:

- Introduction to types of financial markets in Ethiopia
- The purpose of financial markets in Ethiopia
- The role of Banks and Participants in the financial markets

This guide will also assist you to attain the learning outcome stated in the cover page. Specifically, upon completion of this Learning Guide, you will be able to –

- Describe what is meant by the Ethiopian financial markets
- Explain the function and role of the National Bank of Ethiopia (NBE)
- Explain Ethiopia's monetary system
- Explain the key factors that influence the Ethiopian economy
- Describe the role of regulators

Learning Instructions:

1. Read the specific objectives of this Learning Guide.
2. Follow the instructions described in number ____ to ___.
3. Read the information written in the “Information Sheets 1”. Try to understand what are being discussed. Ask you teacher for assistance if you have hard time understanding them.
4. Accomplish the “Self-check 1” in page __.
5. Ask from your teacher the key to correction (key answers) or you can request your teacher to correct your work. (You are to get the key answer only after you finished answering the Self-check 1)

1.1Introduction to types of financial markets in Ethiopia

The National Bank of Ethiopia was established in 1963by proclamation 206 of 1963 and began operation in January 1964. Prior to this proclamation, the Bank used to carry out dual activities, i.e. commercial banking and central banking. The proclamation raised the Bank's capital to Ethiopian dollars 10.0 million and granted broad administrative autonomy and juridical personality
Proclamation

Definition of Bank**:**

Different Authors and Economists have given some structural and functional definitions on Bank from different angles:

" Bank is a financial intermediary institution which deals in loans and advances"--- **Cairn Cross.**

" Bank is an institution which collects idle money temporarily from the public and lends to other people as per need."----
R.P. Kent.

" Bank provides service to its clients and in turn receives perquisites in different forms."--- **P.A. Samuelson**.

" Bank is such an institution which creates money by money only."-----**W. Hock.**

" Bank is such a financial institution which collects money in current, savings or fixed deposit account; collects cheques
as deposits and pays money from the depositors‟ account through cheques."-----**Sir John Pagette.**

Indian Company Law 1936 defines Bank as " a banking company which receives deposits through current account or
any other forms and allows withdrawal through cheques or promissory notes."

Objectives of Bank:

1. To establish as an institution for maximizing profits and to conduct overall economic activities.
2. To collect savings or idle money from the public at a lower rate of interests and lend these public money at a higher
rate of interests.
3. To create propensity of savings amongst the people.
4. To motivate people for investing money with a view to bringing solvency in them .
5. To create money against money as an alternative for enhancing supply of money.

6. To build up capital through savings.
7. To expedite investments.
8. To extend services to the customers.
9. To maintain economic stability by means of controlling money market.
10. To extend co-operation and advices to the Govt. on economic issues.
11. To assist the Govt. for trade& business and socio-economic development.
12. To issue and control notes and currency as a central bank.
13. To maintain and control exchange rates as a central bank.

Meaning and Origin of Bank:

The word „Bank" is widely and extensively used and circulated. The „Bank" in English carries the same meaning in
Bengali. The origin of English word „Bank" came into being (when, where and how) which could not be specifically
identified. The history regarding the origin of „Bank", even after the twelfth century, is not also clear which has been
based on guesses. According to some writer the word „Bank" was derived from „Banco", „Bancus", „Banque" or „Banc" all
of which mean a bench upon which the mediaeval European Money-lenders and Money –Changers used to display
their coins. Anyhow this word has been in use from the middle ages in connection of a bank. In the words of German
writer W. Frankace, a long stool or bench was said to be replaced by Bank, Bangke etc. in the Scandinavian and Mid

Central Bank:

The bank which governs banking system and money market is Central Bank. The primary function of a central bank is
to assist Government in formulating economic policy, in controlling and conducting money-market and also controlling
bank" credit. Some specialized Bankers, Economists and thinkers have given different definitions:
" A central bank is a bank whose essential duty is to maintain stability of the monetary standard."

The objectives of a commercial bank:

1. To establish as an institution for maximizing profits and to conduct overall economic activities.
2. To collect savings or idle money from the public at a lower rate of interests and lend these public money at a higher
rate of interests.

3. To create propensity of savings amongst the people.
4. To motivate people for investing money with a view to bringing solvency in them .
5. To create money against money as an alternative for enhancing supply of money.
6. To build up capital through savings.
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8. To extend services to the customers.
9. To maintain economic stability by means of controlling money market.
10. To extend co-operation and advices to the Govt. on economic issues.
11. To assist the Govt. for trade& business and socio-economic development

The functions of commercial bank are given below:

A: General Functions:

1. Receiving Deposits:

The first and foremost function of commercial bank is to receive or collect deposits from the public in different forms of accounts e.g. current, savings, term deposits. No interest is charged in the current account, lower rate of interest is charged in the savings account and comparatively higher interest rates charged in fixed deposits. Thus, commercial bank builds up customer network.

2. Accommodation of loans and advances:

Commercial Bank attaches much importance to providing loans and advances at a higher rates than the deposit rates and thus earns profits on it. Working capital is accommodated to the borrower for expansion and smooth running of business. In the similar manner, commercial bank extends financial accommodation for the development of agriculture

In the words of Decock, “ The central bank is a banking system in which a single bank has either a complete or a residuary monopoly of note issue.”

Professor Hatley says, “Central Bank is the lender of the last resort.”

Functions of Central Bank:

The functions of central bank are different from other banks. The following functions of central bank are stated below:

The Commercial Bank of Ethiopia (CBE)

The Commercial Bank is established in its present form by a merger of one of the nationalized private bank (Addis Bank) with that of the publicly owned commercial bank by proclamation

No. 184, 1980. It is directed by a board and managed by three mangers (one General and two
Deputies) appointed by the government. The management is supported by detailed monthly and
quarterly reports of the various branch banks

The Inter-Bank Foreign Exchange and Money Markets

The NBE has issued directives aimed at establishing inter-bank foreign exchange and money
markets in 1998 (Directives No. IBM/01/1998 and IBM/02/1998, and other related documents). The establishment of this market is primarily motivated by the recognition that the
foreign exchange supply by NBE through the auction system is not sufficient to satisfy the
demand of banks. The 'inter-bank foreign exchange market' (IBFEM) is a wholesale market,
where the amount traded is large and the spread between buying and selling rates is narrower
than the norms for commercial transaction. It is an exclusive market for banks to trade foreign
exchange with each other (NBE Directive No. IBM/01/1998).
The directive sets various specificity of the market. For instance the minimum amount to be
traded is USD 50,000, banks shall not charge each other any fees, all transaction should be
conducted in strictest confidentiality etc. Banks are also required to report to the NBE about
their foreign exchange operation. Thus, the NBE uses this as one instrument of regulation. It is
also gradually liberalizing the market because all these functions were used to be handled by the
NBE itself. This market is currently very active with a volumes daily inter-bank foreign exchange
transaction of 160 million USD in 2002/03

Formal financial institutions in Ethiopia: The formal sources are financial institutions that are set up legally
and engaged in the provision of credit and mobilization of savings. These institutions are regulated and controlled

by the National Bank of Ethiopia (NBE). In the Ethiopian context formal financial sector includes National Bank of Ethiopia (NBE), commercial banks (owned by private and public), Development Bank of Ethiopia (DBE), credit and savings cooperative, insurance companies (both public and private) and microfinance institutions (owned by regional governments, NGOs, associations and individuals)(NBE, 2013/14). According to the proclamation number 84/94, foreign entry in to the financial sector is not allowed until domestic banks attain a certain degree of desired competitiveness and the National Bank's supervisory and regulatory capacity is adequately strengthened.

The numbers of bank branches reached 2208, of which 1003 or about 45 percent belong to the Commercial Bank of Ethiopia. Despite modest branch expansion, Ethiopia remains as one of the under-banked countries even at sub-Saharan African countries standard. The bank branch to population ratio was 1:43912 in 2013/14 during 20013/14. Similarly, total capital of the banking system reached Birr 37.3 billion, of which about 44.7 percent was hold by government owned 3 banks. Commercial Bank of Ethiopia accounted for more than 34 percent of total capital of the banking system (excluding NBE). Yet geographical distribution of bank branches was highly skewed to major towns and cities. Nearly 34 percent of bank branches were located in Addis Ababa (NBE, 2013/2014).

Total branches of insurance companies reached 332 at the end of the fiscal year (2013/14). The number of insurance companies operating in Ethiopia reached to 17 at the end of the fiscal year (2013/14) and the branch network reached 332 following the opening of 59 additional branches. Major branch expansion was undertaken by the state owned Ethiopian Insurance Corporation (EIC) (13 branches) followed by Abay Insurance (7 branches), Oromia Insurance and Nile Insurance Company (5 branches) each. Yet geographical distribution of insurance branches was highly skewed to major towns and cities. Nearly 55 percent of insurance branches were located in Addis Ababa (NBE, 2013/2014). The share of private insurance companies in total

branches stood at 81.3 percent,
slightly down from 82.1 percent a year ago. On the other hand, total capital of insurance companies increased by
36.6 percent reaching Birr 2.0 billion from Birr 1.5 billion last year. Private insurance companies accounted for
78.6 percent of the total capital of insurance sector while the share of EIC was 21.4 percent.
Microfinance institutions in Ethiopia: Microfinance can be defined as provision of a broad range of
client-responsive financial services to poor people through a wide variety of institutions. Microcredit activities in
rural and urban Ethiopia were initiated by local and international NGOs (Wolday, 2004). According to Pischke
(1996), there were 30 NGOs in Ethiopia who were delivering microcredit services but concentrated in urban areas.
Although the NGOs had contributed to testing innovative methodologies and products, they had the problem of
combining the humanitarian objectives of the NGOs with the financial objectives of the microcredit program. In
Ethiopia integration of the credit schemes initiated by local NGOs like the Relief Society of Tigray (REST) and
Organization for Rehabilitation and Development in Amhara (ORDA) into the formal financial system contributed
to the formulation of a regulatory and supervision framework for efficient delivery of services to the urban and
rural poor and the issuance of a new proclamation for Licensing and Supervision of Micro-Financing Institutions
in 1996 (Proclamation No.40/1996)

Types and Roles of informal Finance in Ethiopia
The term informal refers to the provision of service which is not generally or partly regulated by law but which
relies on self-regulating mechanisms. Moneylenders and pawnbrokers may be required to register, and in that case,
they operate to some extent under formal legislatures. Informal operators are a worldwide phenomenon

Iddir: is one of the informal local institutions in Ethiopia established voluntarily by the community and
involved in self-help and other social activities

ents.
Mahbers: are voluntary and mutual aid community (religious) associations peculiar to Orthodox
religion followers. The members gather together at church or in one of the member's house so as to pray together
to get blessing from God and saint and discuss their problems and further share information. In doing so, the
members bring food and drinks to church to feed the poor and themselves and discuss matters of common interest
(Moges, 2006). Mahbers are also very crucial informal institutions involved in various community activities such
as risk coping, provision of information, addressing manpower and traction force and conflict resolution.
Eqqub:is an informal institutions established voluntarily to collect a specific amount of money from the
members on a specific date to be paid on round and lottery basis to the members

Self-Check 1.1	**Written Test**

Instruction: give short answer for the following questions

1. Write at objective **The objectives of a commercial bank:**

Answer Sheet

Score = ___________

Rating: ____________

1. To establish as an institution for maximizing profits and to conduct overall economic activities.
2. To collect savings or idle money from the public at a lower rate of interests and lend these public money at a higher
rate of interests.
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8. To extend services to the customers.
9. To maintain economic stability by means of controlling money market.

Name: ___________________________ Date: ________________

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1.2 The purpose of financial markets in Ethiopia

The Ethiopian financial sector/policies have evolved through three stylized stages: first, financial repression and fostering state-led industrial and agricultural development through preferential credit (in the socialist regime); second, marketed development through liberalization and deregulation (post 1991); and third, financial inclusion through allowing private banks and MFIs (since second half of 1990s). Proclamation No. 84/1994 that allows the Ethiopian private sector to engage in the banking and insurance businesses and proclamation no. 40/1996 in 1996 that allows the establishment of MFIs mark the beginning of a new era in Ethiopia's financial sector and opened the opportunity for an inclusive financial sector in Ethiopia.

Currently, the Ethiopian financial sector consists of 3 public banks1 including the Development Bank of Ethiopia (DBE), 16 private banks, 14 private insurance companies, 1 public insurance company, 31 microfinance institutions and over 8200 Saving and Credit Cooperatives (SACCOs) in both rural and urban areas. The ownership structure of microfinance institution is mixed, with the big microfinance institutions partially owned by regional states, some by NGO's and some by private owners. The government-owned Commercial Bank of Ethiopia (CBE) is the dominant commercial bank and accounts for 70% of total assets of banks as of May 2013 (See IMF 2013:20). The balance, 30%, is accounted by the other 15 banks. Unlike many government-owned commercial banks, CBE is relatively well run and profitable

The entry of the private sector in the financial sector has created better opportunities for enhanced access to financial services in the country directly through their operations and indirectly through the spillover effect on public financial institutions. As argued by Getahun (2009) the emergence of private banks

with the spirit of competition and emphasis on profitability has led to major shift in the focus of public banks towards a more profit oriented approach. According to him, the Government has restructured these banks granting full operational autonomy, recapitalizing them and cleaning their balance sheets from bad debts accumulated in the previous socialist directed credit delivery system.

1 The state-owned CBE is the dominant commercial bank and accounts for 70% of total assets of banks as of May

2013 (See IMF 2013:20). The balance, 30%, is accounted by all the 15 banks.

Size and coverage of financial services

Size of the financial sector

The Ethiopian financial sector is shallow (African Economic Outlook, 2012) and the coverage of financial services in Ethiopia is low (ADB, 2011). Recent studies estimated that less than 10% of households have access to formal credit (ibid). In addition, there is a lack of more sophisticated financing mechanisms such as leasing, equity funds, etc.

Starting from a very low base, the total asset of the banking system has registered an encouraging growth over the last 10 years. It increased from Birr 153 billion (USD 14.68 billion) in 2008/09 to Birr 400.9 billion (USD 21.9 billion) in 2012/13, an increase of 163%. Though from low base the growth is too fast and now th

NBE has put new regulations that slowdown the increase in the banking sector. 2 It should be noted that the banking system is the largest among the financial sector accounting for over 80% of the total assets of the financial sector

Loan service: The banking sector is one of the major sources in financing the economy by providing loan to individuals, firms and the Government

Financing by the Development Bank of Ethiopia

The Development Bank of Ethiopia (DBE) is a specialized bank to finance medium and long-term investment projects that are in the government's priority sectors such as recently commercial agriculture, agro-processing and manufacturing. It also provides export credit guarantee services to enhance export performance and works as implementing agency for donor financed Rural Financial Intermediation

Financial market performance

The financial markets of the country comprise the money market, the foreign exchange market and the capital market. While the money market is a market for the channeling of short-term funds with maturities not exceeding 12 months from a financial institution with surplus funds to another financial institution with temporary shortfalls in funding, the foreign exchange market is a market for the trading of foreign currencies against the Birr or against other foreign currencies. The capital market, on the other hand, is a market for raising long-term funds. It comprises the equity and bond markets. While the equity market help companies to raise funds by issuing stocks and shares, the bond market relates to a market to raise funds by issuing private debt securities or Government securities.

Financial Inclusion

Financial inclusion is facilitating access to saving and transfer services and provision of credit and insurance at an affordable cost to unbanked poor people who have no access for formal banking system. In dealing with the financial inclusion we took two perspectives: the relationship between banking and inclusion on the one hand and how financial regulation impacts the size and composition of financial sector for financial inclusion on the other.

Financial inclusion is on progress albeit from weak base. One important aspect of this trend is the progress achieved in the coverage of bank services.

FINANCIAL MARKETS

People and organizations wanting to borrow money are brought together with those having surplus funds in the *financial markets.* Note that “markets” is plural; there are a great many different financial markets in a developed economy such as ours. We briefly describe the different types of financial markets and some recent trends in these markets.

Types of Markets

Different financial markets serve different types of customers or different parts of the country. Financial markets also vary depending on the maturity of the securities being traded and the types of assets used to back the securities.

For these reasons it is often useful to classify markets along the following dimensions:

1. *Physical asset versus financial asset markets. Physical asset markets* (also called “tangible” or “real” asset markets) are those for products such as wheat, autos, real estate, computers, and machinery. *Financial asset markets*, on the other hand, deal with stocks, bonds, notes, mortgages, and other *claims on real assets*, as well as with *derivative securities* whose values are *derived* from changes in the prices of other assets. A share of Ford stock is a “pure financial asset,” while an option to buy Ford shares is a derivative security whose value depends on the price of Ford stock.

2. *Spot versus futures markets*. **Spot markets** are markets in which assets are bought or sold for “on-the-spot” delivery (literally, within a few days).

Futures markets are markets in which participants agree today to buy or sell an asset at some future date. For example, a farmer may enter into a futures contract in which he agrees today to sell 5,000 bushels of soybeans six months from now at a price of $5 a bushel. On the other side, an international food producer looking to buy soybeans in the future may enter into a futures contract in which it agrees to buy soybeans six months from now.

3. *Money versus capital markets.* **Money markets** are the markets for short-term, highly liquid debt securities. The New York, London, and Tokyo money markets are among the world's largest. **Capital markets** are the markets for intermediate- or long-term debt and corporate stocks. The New York Stock Exchange, where the stocks of the largest U.S. corporations are traded, is a prime example of a capital market. There is no hard and fast rule on this, but when describing debt markets, "short term" generally means less than 1 year, "intermediate term" means 1 to 10 years, and "long term" means more than 10 years.

4. *Primary versus secondary markets.* **Primary markets** are the markets in which corporations raise new capital. If GE were to sell a new issue of common stock to raise capital, this would be a primary market transaction. The corporation selling the newly created stock receives the proceeds from the sale in a primary market transaction. **Secondary markets** are markets in which existing, already outstanding, securities are traded among investors. Thus, if Jane Doe decided to buy 1,000 shares of GE stock, the purchase would occur in the secondary market. The New York Stock Exchange is a secondary market because it deals in outstanding, as opposed to newly issued, stocks and bonds. Secondary markets also exist for mortgages, various other types of loans, and other financial assets. The corporation whose securities are being traded is not involved in a secondary market transaction and, thus, does not receive any funds from such a sale.

5 Private versus public markets. **Private markets,** where transactions are negotiated directly between two parties, are differentiated from **public markets,** where standardized contracts are traded on organized exchanges. Bank loans and private debt placements with insurance companies are examples of private market transactions. Because these transactions are private, they may be structured in any manner that appeals to the two parties

Self-Check 1.2	Written Test

Instruction: give short answer for the following questions

1explain the term financial *markets*

Answer Sheet

Score = ___________

Rating: ____________

Name: _________________________ Date: _______________

Short Answer Questions..

People and organizations wanting to borrow money are brought together with those having surplus funds in the *financial market*

1.3 <u>The role of Banks and Participants in the financial markets</u>

FINANCIAL INSTITUTIONS

Direct funds transfers are more common among individuals and small businesses, and in economies where financial markets and institutions are less developed. While businesses in more developed economies do occasionally rely on direct transfers, they generally find it more efficient to enlist the services of one or more financial institutions when it comes time to raise capital.

many different markets. As a result, the differences between institutions have tended to become blurred. Still, there remains a degree of institutional identity, and therefore it is useful to describe the major categories of financial institutions here:

1. Investment banking houses such as Merrill Lynch, Morgan Stanley, Goldman Sachs, or Credit Suisse Group provide a number of services to both investors and companies planning to raise capital. Such organizations (a) help

corporations design securities with features that are currently attractive to investors, (b) then buy these securities from the corporation, and (c) resell them to savers. Although the securities are sold twice, this process is really one primary market transaction, with the investment banker acting as a facilitator to help transfer capital from savers to businesses.

2. Commercial banks, such as Bank of America, Wells Fargo, Wachovia, and J. P. Morgan Chase, are the traditional "department stores of finance" because they serve a variety of savers and borrowers. Historically, commercial banks were the major institutions that handled checking accounts and through which the Federal Reserve System expanded or contracted the money supply. Today, however, several other institutions also provide checking services and significantly influence the money supply. Conversely, commercial banks are providing an ever-widening range of services, including stock brokerage services and insurance.

3. Financial services corporations are large conglomerates that combine many different financial institutions within a single corporation. Examples of financial services corporations, most of which started in one area but have now diversified to cover most of the financial spectrum, include Citigroup, American Express, Fidelity, and Prudential.

4.*Savings and loan associations (S&Ls)* traditionally served individual savers and residential and commercial mortgage borrowers, taking the funds of many small savers and then lending this money to home buyers and other types of borrowers. In the 1980s, the S&L industry experienced severe problems when (a) short-term interest rates paid on savings accounts rose well above the returns earned on the existing mortgages held by S&Ls and (b) commercial real estate suffered a severe slump, resulting in high mortgage default rates. Together, these events forced many S&Ls to merge with stronger institutions or close their doors.

Mutual savings banks, which are similar to S&Ls, operate primarily in the northeastern states, accepting savings primarily from individuals, and lending mainly on a long-term basis to home buyers and consumers.

Credit unions are cooperative associations whose members are supposed to have a common bond, such as being employees of the same firm. Members' savings are loaned only to other members, generally for auto purchases, home improvement loans, and home mortgages. Credit unions are often the cheapest source of funds available to individual borrowers.

. *Pension funds* are retirement plans funded by corporations or government agencies for their workers and administered primarily by the trust departments of commercial banks or by life insurance companies. Pension funds invest primarily in bonds, stocks, mortgages, and real estate.

. *Life insurance companies* take savings in the form of annual premiums; invest these funds in stocks, bonds, real estate, and mortgages; and finally make payments to the beneficiaries of the insured parties. In recent years, life insurance companies have also offered a variety of tax-deferred savings plans designed to provide benefits to the participants when they retire.

Mutual funds are corporations that accept money from savers and then use these funds to buy stocks, long-term bonds, or short-term debt instruments issued by businesses or government units. These organizations pool funds and thus reduce risks by diversification. They also achieve economies of scale in analyzing securities, managing portfolios, and buying and selling securities. Different funds are designed to meet the objectives of different types of savers. Hence, there are bond funds for those who desire safety, stock funds for savers who are willing to accept significant risks in the hope of higher returns, and still other funds that are used as interest-bearing

Investment Banking House

An organization that underwrites and distributes new investment securities and helps businesses obtain financing.

Commercial Bank

Traditional department store of finance serving a variety of savers and borrowers.

Financial Services Corporation

A firm that offers a wide range of financial services, including investment banking, brokerage operations, insurance, and commercial banking

Mutual Funds

Organizations that pool investor funds to purchase financial instruments and thus reduce *risks through diversification.*

Money Market Funds

Mutual funds that invest in short-term, low-risk securities and allow investors to write checks against their accounts

○

Self-Check 1.3	**Written Test**

Instruction: give short answer for the following questions

1explainthe term financial institution

Answer Sheet

Score = ___________

Rating: ____________

Name: _________________________   Date: _______________

Short Answer Questions

Direct funds transfers are more common among individuals and small businesses, and in economies where financial markets and institutions are less developed. While businesses in more developed economies do occasionally rely on

Instruction Sheet	LG21. Explaining the function and role of the National Bank of Ethiopia (NBE)

This learning guide is developed to provide you the necessary information regarding the following content coverage and topics

- The ***role of the NBE*** and other banks
- The importance and ***effect of the NBE's monetary policy***

This guide will also assist you to attain the learning outcome stated in the cover page. Specifically, upon completion of this Learning Guide, you will be able to –

- Describe what is meant by the Ethiopian financial markets
- Explain the function and role of the National Bank of Ethiopia (NBE)
- Explain Ethiopia's monetary system
- Explain the key factors that influence the Ethiopian economy
- Describe the role of regulators

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1. Read the specific objectives of this Learning Guide.
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- **2.1**. The ***role of the NBE*** and other banks

- THE ROLE OF THE ETHIOPIAN GOVERNMENT IN THE FINANCIAL SECTOR
The government pursues a two-pronged policy as far as the financial sector is concerned. On the one hand, maintaining a stable macroeconomic environment and a sound financial system are the key monetary policy objectives of the government. Improving the operational quality and efficiency of the financial sector are its stated objectives. Three strategies have been reflected in the SDPRP document, namely (a) creating a favorable environment for the banking sector (b) building internal dynamics of the banks (c) promoting contestability of the
market in the banking sector.
On the other hand, the government has encouraged the development of micro financial services, largely to the rural people. The agricultural development strategy (2001) of the government takes rural finance as one of the key factors for enhancing agricultural production and ensuring food security

the National Bank of Ethiopia was entrusted with the following responsibilities.

- » To regulate the supply, availability and cost of money and credit.
- » To manage and administer the country's international reserves.
- » To license and supervise banks and hold commercial banks reserves and lend money to them.
- » To supervise loans of commercial banks and regulate interest rates.
- » To issue paper money and coins.
- » To act as an agent of the Government.
- » To fix and control the foreign exchange rates.
- The agreement that was reached in 1905 between Emperor Minilik II and Mr.MaGillivray, representative of the British owned National Bank of Egypt marked the introduction of modern banking in Ethiopia. Following the agreement, the first bank called Bank of Abysinia was inaugurated in Feb.16, 1906 by the Emperor. The Bank was totally managed by the Egyptian National Bank and the following rights and concessions were agreed upon the establishment of Bank of Abyssinia:-
- » The capital of the Bank was agreed to be Pound Sterling 500,000 and one-fifth was subscribed and the rest was to be obtained by selling shares in some important cities such as London, Paris and New York.» The Bank was given full rights to issue bank notes and monitor coins which were to be legal tender and all the profits there from a ruing to the bank and freely exchangeable against gold and silver on cover by the Bank as well as to establish silver coins and abolish the Maria Theresa.» Land

was given to the Bank free of charges & permitted to build offices and warehouses. Government and public funds were to be deposited with the bank and all payments to be made by checks.» The government promised not to allow any bank to be established in the country within the 50-year concession period.

- Within the first fifteen years of its operation, Bank of Abyssinia opened branches in different areas of the country. In 1906 a branch in Harar (Eastern Ethiopia) was opened at the same time of the inauguration of Bank of Abyssinia in Addis Ababa. Another at Dire Dawa was opened two years later and at Gore in 1912 and at Dessie and Djibouti in 1920. Mac Gillivray, the then representative and negotiator of Bank of Egypt, was appointed to be the governor of the new bank and he was succeeded by H Goldie, Miles Backhouse, and CS Collier were in change from 1919 until the Bank's liquidation in 1931.
- » The National Bank of Ethiopia (NBE)» The Commercial Bank of Ethiopia (CBE)» Agricultural and Industrial Development Bank (AIDB)Following the demise of the Dergue regime in 1991 that ruled the country for 17 years under the rule of command economy, the EPRDF declared a liberal economy system. In line with this, Monetary and Banking proclamation of 1994 established the national bank of Ethiopia as a judicial entity, separated from the government and outlined its main function.Monetary and Banking proclamation No.83/1994 and the Licensing and Supervision of Banking Business No.84/1994 laid down the legal basis for investment in the banking sector. Consequently shortly after the proclamation the first private bank, Awash International Bank was established in 1994 by 486 shareholders and by 1998 the authorized capital of the Bank reached Birr 50.0 million. Dashen Bank was established on September 20,1995 as a share company with an authorized and subscribed capital of Birr 50.0 million. 131 shareholders with subscribed and authorized capital of 25.0 million and 50 million founded bank of Abysinia. Wegagen Bank with an authorized capital of Birr 60.0 million started operation in 1997. The fifth private bank, United Bank was established on 10th September 1998 by 335 shareholders .Nib International Bank that started operation on May 26, 1999 with an authorized capital of Birr 150.0 million. Cooperative Bank of Oromia was established on October 29,2004 with an authorized capital of Birr 22.0 million. Lion International Bank with an authorized capital of Birr 108 million started operation in October 02,2006. Zemen Bank that started operation on June 17, 2008 with an authorized capital of Birr 87.0 million. The last bank to be established to date is Oromia International Bank that started operation on September 18, 2008 with an authorized capital of Birr 91 million.

2.1Self-Check	Written Test

Instruction: give short answer for the following questions

1explain **the National Bank of Ethiopia responsibilities**.

Answer Sheet

Score = ___________

Rating: ____________

- **the National Bank of Ethiopia was entrusted with the following responsibilities**.
- » To regulate the supply, availability and cost of money and credit.
- » To manage and administer the country's international reserves.
- » To license and supervise banks and hold commercial banks reserves and lend money to them.
- » To supervise loans of commercial banks and regulate interest rates.
- » To issue paper money and coins.
- » To act as an agent of the Government.
- » To fix and control the foreign exchange rates.

Name: ___________________________ Date: ________________

2.2 The importance and ***effect of the NBE's monetary policy***

Monetary policy Framework of Ethiopia

Economic Research and Monetary Policy Process, NBE 1

Monetary policy of central banks in a simplified analysis amounts to the determination of the “optimal” quantity of money or (in a dynamic sense) the optimal rate of growth of the money stock. But there is more to monetary policy than the determination of the optimal stock or growth rate of money. More generally, monetary policy refers to a bundle of actions and regulatory stances taken by the central bank including all of the following: ü Setting minimum interest rates on deposits or the rediscount rate charged to Commercial banks borrowing reserves; ü Setting reserve requirements on various classes of deposits; ü Increasing or decreasing commercial bank reserves through open market purchases or sales of government securities.

ü Regulatory actions to constrain commercial bank financial activity or to set minimum capital requirements;

ü Intervention in foreign exchange markets to buy and sell domestic currency for foreign exchange; ü Decide on level of required reserve of commercial banks total deposit It is self-evident that monetary policy plays an important role in the performance of an economy. However, the effectiveness of the policy in achieving the intended goal largely depends on the institutional factors that constrain or facilitate the implementation process of the policy. In what follows the monetary policy framework of the National Bank of Ethiopia will be described detailing the monetary policy objectives, the targeting framework, the instruments of monetary policy and legal & institutional framework of the monetary policy decision-making structure as well as the exchange rate regime of the country

Monetary Policy Objective

The principal objective of the monetary policy of the National Bank of Ethiopia is to maintain price & exchange rate stability and support sustainable economic growth of Ethiopia. Price stability is a proxy for macroeconomic stability which is vital in private sector economic decision on investment, consumption, international trade and saving. Finally, macroeconomic stability fosters employment and economic growth. Maintaining exchange rate stability on the other hand

Instruction: give short answer for the following questions

1 define the term monetary policy objective ?

Answer Sheet

Score = ___________

Rating: ____________

Name: _________________________ Date: _______________

Short Answer Questions

The principal objective of the monetary policy of the National Bank of Ethiopia is to maintain price & exchange rate stability and support sustainable economic growth of Ethiopia. Price stability is a proxy for macroeconomic stability which is vital in private sector economic decision on investment, consumption, international trade and saving. Finally, macroeconomic stability fosters employment and economic growth. Maintaining exchange rate stability on the other hand

This learning guide is developed to provide you the necessary information regarding the following content coverage and topics:

- Various ***functions of money***
- The monetary cycle
- ***instruments traded on the short term money market***
- The impact of increases and decreases in the money supply

This guide will also assist you to attain the learning outcome stated in the cover page. Specifically, upon completion of this Learning Guide, you will be able to –.

- Describe what is meant by the Ethiopian financial markets
- Explain the function and role of the National Bank of Ethiopia (NBE)
- Explain Ethiopia's monetary system
- Explain the key factors that influence the Ethiopian economy
- Describe the role of regulators

Learning Instructions:

1. Read the specific objectives of this Learning Guide.
2. Follow the instructions described below.
3. Read the information written in the “Information Sheet”. Try to understand what are being discussed. Ask you teacher for assistance if you have hard time understanding them.
4. Accomplish the “Self-check” in page __.
5. Ask from your teacher the key to correction (key answers) or you can request your teacher to correct your work. (You are to get the key answer only after you finished answering the Self-check).

Introduction

Monetary policy of central banks in a simplified analysis amounts to the determination of the "optimal" quantity of money or (in a dynamic sense) the optimal rate of growth of the money stock. But there is more to monetary policy than the determination of the optimal stock or growth rate of money. More generally, monetary policy refers to a bundle of actions and regulatory
stances taken by the central bank including all of the following:

 Setting minimum interest rates on deposits or the rediscount rate charged to Commercial banks borrowing reserves;

 Setting reserve requirements on various classes of deposits;

 Increasing or decreasing commercial bank reserves through open market purchases or sales of government securities.

 Regulatory actions to constrain commercial bank financial activity or to set minimum capital requirements;

 Intervention in foreign exchange markets to buy and sell domestic currency for foreign exchange;

 Decide on level of required reserve of commercial banks total deposit

It is self-evident that monetary policy plays an important role in the performance of an economy. However, the effectiveness of the policy in achieving the intended goal largely depends on the institutional factors that constrain or facilitate the implementation process of the policy. In what follows the monetary policy framework of the National Bank of Ethiopia will be described detailing the monetary policy objectives, the targeting framework, the instruments of monetary policy and legal & institutional framework of the monetary policy decision-making structure as well as the exchange rate regime of the country.

Monetary policy Framework of Ethiopia

Economic Research and Monetary Policy Process, NBE

. Monetary Policy Objective

The principal objective of the monetary policy of the National Bank of Ethiopia is to maintain

price & exchange rate stability and support sustainable economic growth of Ethiopia. Price
stability is a proxy for macroeconomic stability which is vital in private sector economic decision on investment, consumption, international trade and saving. Finally, macroeconomic stability
fosters employment and economic growth. Maintaining exchange rate stability on the other hand is considered as the principal policy objective of NBE so as to be competitive in the international trade and to use exchange rate intervention as policy tools for monetary policy to affect both
foreign reserve position and domestic money supply.

More specifically, the objectives of Ethiopia's monetary policy are to:

 Foster monetary, credit and financial conditions conducive to orderly, balanced and sustained economic growth and development.

 Preserve the purchasing power of the national currency – ensuring that the level of money supply is generally consistent with developments in the macro- economy and intervening in the foreign exchange rate market for the purpose of stabilizing the rate when conditions necessitate.

 Encourage the mobilization of domestic and foreign savings and their efficient allocation for productive economic activities through the implementation of a prudent market driven interest rate policy.

 Facilitate the emergence of financial and capital markets that are capable of responding to the needs of the economy through appropriate policy measures. These measures would ensure the gradual introduction of trading instruments on a short-term basis

3,1Various ***functions of money***

Money for the sake of money is not an end in itself. You cannot eat dollar bills or wear your bank account. Ultimately, the usefulness of money rests in exchanging it for goods or services. As the American writer and humorist Ambrose Bierce (1842–1914) wrote in 1911, money is a "blessing that is of no advantage to us excepting when we part with it." Money is what people regularly use when purchasing or selling goods and services, and thus money must be widely accepted by both buyers and sellers. This concept of money is intentionally flexible, because money has taken a wide variety of forms in different cultures.

Barter and the Double Coincidence of Wants

To understand the usefulness of money, we must consider what the world would be like without money. How would people exchange goods and services? Economies without money typically engage in the barter system. **Barter**—literally trading one good or service for another—is highly inefficient for trying to coordinate the trades in a modern advanced economy. In an economy without money, an exchange between two people would involve a **double coincidence of wants**, a situation in which two people each want some good or service that the other person can provide. For example, if an accountant wants a pair of shoes, this accountant must find someone who has a pair of shoes in the correct size and who is willing to exchange the shoes for some hours of accounting services. Such a trade is likely to be difficult to arrange. Think about the complexity of such trades in a modern economy, with its extensive division of labor that involves thousands upon thousands of different jobs and goods.

Another problem with the barter system is that it does not allow us to easily enter into future contracts for the purchase of many goods and services. For example, if the goods are perishable it may be difficult to exchange them for other goods in the future. Imagine a farmer wanting to buy a tractor in six months using a fresh crop of strawberries. Additionally, while the barter system might work adequately in small economies, it will keep these economies from growing. The time that individuals would otherwise spend producing goods and services and enjoying leisure time is spent bartering.

Functions for Money

Money solves the problems created by the barter system. (We will get to its definition soon.) First, money serves as a **medium of exchange**, which means that money acts as an intermediary between the buyer and the seller. Instead of exchanging accounting services for shoes, the accountant now exchanges accounting services for money. This money is then used to buy shoes. To serve as a medium of exchange, money must be very widely accepted as a method of payment in the markets for goods, labor, and financial capital.

Second, money must serve as a **store of value**. In a barter system, we saw the example of the shoemaker trading shoes for accounting services. But she risks having her shoes go out of style, especially if she keeps them in a warehouse for future use—their value will decrease with each season. Shoes are not a good store of value. Holding money is a much easier way of storing value. You know that you do not need to spend it immediately because it will still hold its value the next day, or the next year. This function of money does not require that money is a *perfect* store of value. In an economy with inflation, money loses some buying power each year, but it remains money.

Third, money serves as a **unit of account**, which means that it is the ruler by which other values are measured. For example, an accountant may charge $100 to file your tax return. That $100 can purchase two pair of shoes at $50 a pair. Money acts as a common denominator, an accounting method that simplifies thinking about trade-offs.

Finally, another function of money is that money must serve as a **standard of deferred payment**. This means that if money is usable today to make purchases, it must also be acceptable to make purchases today that will be paid in the *future*. Loans and future agreements are stated in monetary terms and the standard of deferred payment is what allows us to buy goods and services today and pay in the future. So **money** serves all of these functions— it is a medium of exchange, store of value, unit of account, and standard of deferred payment.

Commodity versus Fiat Money

Money has taken a wide variety of forms in different cultures. Gold, silver, cowrie shells, cigarettes, and even cocoa beans have been used as money. Although these items are used as **commodity money**, they also have a value from use as something other than money. Gold, for example, has been used throughout the ages as money although today it is not used as money but rather is valued for its other attributes. Gold is a good conductor of electricity and is used in the electronics and aerospace industry. Gold is also used in the manufacturing of energy efficient reflective glass for skyscrapers and is used in the medical industry as well. Of course, gold also has value because of its beauty and malleability in the creation of jewelry.

As commodity money, gold has historically served its purpose as a medium of exchange, a store of value, and as a unit of account. **Commodity-backed currencies** are dollar bills or other currencies with values backed up by gold or other commodity held at a bank. During much of its history, the money supply in the United States was backed by gold and silver. Interestingly, antique dollars dated as late as 1957, have “Silver Certificate” printed over the portrait of George Washington, as shown in Figure 1. This meant that the holder could take the bill to the appropriate bank and exchange it for a dollar’s worth of silver.

Figure 1. A Silver Certificate and a Modern U.S. Bill. Until 1958, silver certificates were commodity-backed money—backed by silver, as indicated by the words “Silver Certificate” printed on the bill. Today, U.S. bills are backed by the Federal Reserve, but as fiat money. (Credit: “The.Comedian”/Flickr Creative Commons

Self check exercise 3.1	Written test

Instruction: give short answer for the following questions.

1 explain the term Monetary Policy Objective

Answer Sheet

Score = ___________
Rating: ____________

Name: _________________________ Date: _______________

Part one: Short Answer Questions

The principal objective of the monetary policy of the National Bank of Ethiopia is to maintain price & exchange rate stability and support sustainable economic growth of Ethiopia. Price stability is a proxy for macroeconomic stability which is vital in private sector economic decision on investment, consumption, international trade and saving. Finally, macroeconomic stability fosters employment and economic growth

3.2 The monetary cycle

The **business cycle**, also known as the **economic cycle** or **trade cycle**, is the downward and upward movement of gross domestic product (GDP) around its long-term growth trend.[1] The length of a business cycle is the period of time containing a single boom and contraction in sequence. These fluctuations typically involve shifts over time between periods of relatively rapid economic growth (expansions or booms) and periods of relative stagnation or decline (contractions or recessions).

Business cycles are usually measured by considering the growth rate of real gross domestic product. Despite the often-applied term cycles, these fluctuations in economic activity do not exhibit uniform or predictable periodicity. The common or popular usage **boom-and-bust cycle** refers to fluctuations in which the expansion is rapid and the contraction severe

Monetary policy—adjustments to interest rates and the money supply—can play an important role in combating economic slowdowns. Such adjustments can be made quickly, and monetary authorities devote considerable resources to monitoring and analyzing the economy. Monetary policy can offset a downturn because lower interest rates reduce consumers' cost of borrowing to buy big-ticket items such as cars or houses. For firms, monetary policy can also reduce the cost of investment. For that reason, lower interest rates can increase spending by both households and firms, boosting the economy.

The Federal Reserve can adjust monetary policy more quickly than the president and Congress can adjust fiscal policy. Because most contractions in economic activity last for only a few quarters, a prompt policy response is crucial. Yet fiscal policy in practice responds slowly to changes in economic conditions: it takes time first to enact a stimulus bill and then to implement it, and time for the spending increases or tax reductions to reach consumers' pockets. As a result, the effect of fiscal stimulus on household and business spending may come too late.

Whether and how much stimulus is needed depends on present economic conditions, on projections of future conditions, and on possible risks to both economic activity and inflation. Forecasting economic conditions—or even determining the current state of the economy—is inherently difficult, given limitations in the data available and in economists' understanding of the world. But the Federal Reserve's large and sophisticated team of analysts is better positioned to accomplish this task than any other agency of the federal government. In addition, the Federal Reserve staff carries out this work independent of political considerations.

The potential of monetary policy to combat extreme events is limited, however, because its primary tool is the short-run interest rate, and that rate can't fall below zero. That means that in a particularly severe downturn such as the recent Great Recession, the Federal Reserve will reduce the short-run interest rate to zero, after which the Fed can employ only less effective and well-understood policies such as asset purchases. Under those conditions, fiscal policy may complement monetary policy in boosting the economy.

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Self check exercise3.2	Written test

Instruction: give short answer for the following questions.

1 explain The **business cycle**, also known as the **economic cycle** or **trade cycle**,

Score = ___________
Rating: ____________

Answer Sheet

is the downward and upward movement of gross domestic product (GDP) around its long-term growth trend.[1] The length of a business cycle is the period of time containing a single boom and contraction in sequence. These fluctuations typically involve shifts over time between periods of relatively rapid economic growth (expansions or booms) and periods of relative stagnation or decline (contractions or recessions).

Business cycles are usually measured by considering the growth rate of real gross domestic product. Despite the often-applied term cycles, these fluctuations in economic activity do not exhibit uniform or predictable periodicity

Reference

https://www.taxpolicycenter.org/briefing-book/what-role-monetary-policy-business-cycles

3,3. *instruments traded on the short term money market*

The **money market** is a component of the economy which provides short-term funds. The money market deals in short-term loans, generally for a period of less than or equal to 365 days.

As money became a commodity, the **money market** became a component of the financial market for assets involved in short-term borrowing, lending, buying and selling with original maturities of one year or less. Trading in money markets is done over the counter and is wholesale.

There are several money market instruments in most Western countries, including treasury bills, commercial paper, bankers' acceptances, deposits, certificates of deposit, bills of exchange, repurchase agreements, federal funds, and short-lived mortgage- and asset-backed securities.[1] The instruments bear differing maturities, currencies, credit risks, and structures.[2]

Money markets, which provide liquidity for the global financial system including for capital markets, are part of the broader system of financial markets.

Money market instruments

- Certificate of deposit – Time deposit, commonly offered to consumers by banks, thrift institutions, and credit unions.
- Repurchase agreements – Short-term loans—normally for less than one week and frequently for one day—arranged by selling securities to an investor with an agreement to repurchase them at a fixed price on a fixed date.
- Commercial paper – Short term instruments promissory notes issued by company at discount to face value and redeemed at face value
- Eurodollar deposit – Deposits made in U.S. dollars at a bank or bank branch located outside the United States.
- Federal agency short-term securities – In the U.S., short-term securities issued by government sponsored enterprises such as the Farm Credit System, the Federal Home Loan Banks and the Federal National Mortgage Association. Money markets is heavily used function.
- Federal funds – In the U.S., interest-bearing deposits held by banks and other depository institutions at the Federal Reserve; these are immediately available funds that institutions borrow or lend, usually on an overnight basis. They are lent for the federal funds rate.
- Municipal notes – In the U.S., short-term notes issued by municipalities in anticipation of tax receipts or other revenues
- Treasury bills – Short-term debt obligations of a national government that are issued to mature in three to twelve months

- Money funds – Pooled short-maturity, high-quality investments that buy money market securities on behalf of retail or institutional investors
- Foreign exchange swaps – Exchanging a set of currencies in spot date and the reversal of the exchange of currencies at a predetermined time in the future
- Short-lived mortgage- and asset-backed securities

Discount and accrual instruments

There are two types of instruments in the fixed income market that pay interest at maturity, instead of as coupons—discount instruments and accrual instruments. Discount instruments, like repurchase agreements, are issued at a discount of face value, and their maturity value is the face value. Accrual instruments are issued at face value and mature at face value plus interest.

Self check	Written test

Instruction: give short answer for the following questions.

1 list some of the Money market instruments

answer

- Certificate of deposit
- Commercial paper

Score = ___________
Rating: ____________

3.3The impact of increases and decreases in the money supply

As economies grew and became more global in nature, the use of commodity monies became more cumbersome. Countries moved towards the use of **fiat money**. Fiat money has no intrinsic value, but is declared by a government to be the legal tender of a country. The United States' paper money, for example, carries the statement: "THIS NOTE IS LEGAL TENDER FOR ALL DEBTS, PUBLIC AND PRIVATE." In other words, by government decree, if you owe a debt, then legally speaking, you can pay that debt with the U.S. currency, even though it is not backed by a commodity. The only backing of our money is universal faith and trust that the currency has value, and nothing

Key Concepts and Summary

Money is what people in a society regularly use when purchasing or selling goods and services. If money were not available, people would need to barter with each other, meaning that each person would need to identify others with whom they have a double coincidence of wants—that is, each party has a specific good or service that the other desires. Money serves several functions: a medium of exchange, a unit of account, a store of value, and a standard of deferred payment. There are two types of money: commodity money, which is an item used as money, but which also has value from its use as something other than money; and fiat money, which has no intrinsic value, but is declared by a government to be the legal tender of a country.

Self check exercise 3.4 **Written test**

Instruction: give short answer for the following questions

1. 1What are the four functions served by money?

Answer Sheet

Score = ____________

Rating: _____________

Name: _________________________ Date: _______________

Part one: Short Answer Questions

1.Money is what people in a society regularly use when purchasing or selling goods and services. If money were not available, people would need to barter with each other, meaning that each person would need to identify others with whom they have a double coincidence of wants—that is, each party has a specific good or service ____

____

____

2.____

This learning guide is developed to provide you the necessary information regarding the following content coverage and topics:

- **Explaining the key factors that influence the Ethiopian economy**
    - The role and impact of global market situation and Federal and Regional State
    - The impact of a change in domestic interest rates in different sector of the economy
    - The impact of changes in ***consumer activity*** on Ethiopian economy

This guide will also assist you to attain the learning outcome stated in the cover page. Specifically, upon completion of this Learning Guide, you will be able to –.

- Describe what is meant by the Ethiopian financial markets
- Explain the function and role of the National Bank of Ethiopia (NBE)
- Explain Ethiopia's monetary system
- Explain the key factors that influence the Ethiopian economy
- Describe the role of regulators

Learning Instructions:

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Information sheet	Explaining the key factors that influence the Ethiopian economy

4.1. The role and impact of global market situation and Federal and Regional State

Globalization has often been blamed for the rapid rise in obesity in much of the developing world . The existing evidence for this claim does, however, rest primarily on case studies and simple ecological comparisons of national conditions. A notable exception is a recent study by who explored the influence of economic globalization (e.g. foreign direct investment or trade) on obesity world-wide. Arguably, the scarcity of quantitative data amenable to statistical analysis relates to the difficulty in quantifying the complex, multi-faceted nature of globalization. Economists were among the first to try to quantify the different components of globalization in their attempt to assess its impact on economic growth Indeed, the measures of globalization commonly employed have been exclusively economic, commonly proxies by e.g. total imports and exports or foreign direct investment, expressed as a share in GDP. Yet, globalization is not solely an economic process, and even if it were, there is more to economic globalization than the mere flow of goods and capital.

More recent efforts at measuring globalization were built on the conceptualization by of three different relevant dimensions of globalization: (1) economic: long distance flows of goods, capital and services as well as information and perceptions that accompany market exchanges, (2) political: the diffusion of government policies internationally, and (3) social: the spread of ideas, information, images, and people (have developed the so-called KOF index of globalization to capture each of these dimensions (as well as additional sub-dimensions). For all dimensions, this index was created using comprehensive data collected annually, from 1970 to 2013. In this paper we make use of this new measure and its various components, to arrive at a more detailed and nuanced assessment of the impact of different dimensions of globalization on overweight in low- and middle-income countries.

All three of these components of globalization might have contributed to obesity in low- and middle-income countries, and because they capture different dimensions and – as will be shown further below – are at best imperfectly correlated with each other, it is important to examine the influence of each sub-dimension separately. Taken together, globalization may be contributing to obesity by stimulating increased calorie consumption, and/or smaller energy expenditure. While there exists a considerable literature which considers the role of technological change in affecting energy expenditure and consumption

Modern Business Sectors

Ever wonder what changes the price of gas? Or why butter is a dollar more this year than last? There's more to it than you might think! Not all business markets are the same - that's especially true of the modern business markets. The **modern economy** is essentially made up of three distinct sectors: primary, secondary, and tertiary.

- The **primary sector** is involved in extracting raw materials from the earth
- The **secondary sector** is involved in transforming the raw resources into products through industrialization
- The **tertiary sector** is involved in providing services to businesses and consumers: this includes restaurants, retail, sales, and transportation

In the developed nations, economies have been specialized in the service industries while manufacturing and the extraction of raw resources have for the most part shifted to developing nations.

Of course, it's not as simple as distribution falling exclusively to either a developed or developing nation. Each country's economic activity encompasses all three sectors and can depend on geography, resources, labor, technology, access to markets, and politics. Distinct economic, social, and political factors influence and shape the type of business markets within each country.

Economic Forces

Neither economic conditions nor business markets exist in a vacuum. Other forces bear direct effect in regional and global economic realities. **Economic forces** are factors such as monetary and fiscal policies, interest rate, employment, inflation rate, demographic changes, political changes, energy, security, and natural disasters. All of these have a direct effect on how businesses produce and distribute their products or services. The effect of these economic forces in business is reflected in the economy. The **four main economic forces or trends** that affect modern business markets are:

1. Government influence
2. International transactions
3. Expectation and speculation
4. Supply and demand for products

While not included as a major economic force in classic economic models, technology, particularly the internet, also has a major role in shaping modern business markets. Markets have also become sensitive to the corporate social responsibility (CSR), or corporate citizenship model, and the forward-thinking concept of responsible business sustainability.

Let's take a look at these major economic forces.

Government Influence

Government influence is a major economic force in all business markets. In the United States, the government and the Federal Reserve can raise or lower interest rates to control economic growth. This process is called monetary policy.

Through its fiscal policy, the government can decrease or increase spending as the means of stabilizing prices or easing unemployment. Also, the government can raise or lower taxes on business activities. Other business markets are highly regulated by the government such as banking, trading, manufacturing, and medicine. Other business sectors also receive government subsidies in either direct investment or tax breaks. In some instances, such as the banking financial crisis of 2008, the government intervenes aggressively to avert broader economic disasters.

International Transaction

International transaction is a very important financial force. The flow of financial transactions between countries affects the country's economy and its currency. For example, the direction of capital flow can either strengthen or weaken a country's economy and currency.

In the case of import and export, a trade imbalance can be positive or negative, depending on the position of each country. However, countries like China artificially keep the value of its currency low as the means of gaining trade advantages against competitors. This is where a country's trading policy has a direct impact on export/import and manufacturing markets.

Self chech exercise 4.1	Written test

Instruction: give short answer for the following questions

1The **four main economic forces or trends** that affect modern business markets

Answer Sheet

Score = ___________
Rating: ____________

Name: _________________________ Date: _______________

Short Answer Questions

5. Government influence
6. International transactions
7. Expectation and speculation
8. Supply and demand for products

4.2The impact of a change in domestic interest rates in different sector of the

Changes in interest rates can have both positive and negative effects on the U.S. markets. When the Federal Reserve Bond (the Fed) changes the rate at which banks borrow money, this has a ripple effect across the entire economy. Below, we will examine how interest rates can have an effect on the economy as a whole, the stock and bond markets, inflation and recessions.

How Interest Rates Affect Spending

With every loan, there is a possibility that the borrower will not repay the money. To compensate lenders for that risk, there must be a reward: interest. Interest is the amount of money that lenders earn when they make a loan that the borrower repays, and the interest rate is the percentage of the loan amount that the lender charges to lend money.

The existence of interest allows borrowers to spend money immediately, instead of waiting to save the money to make a purchase. The lower the interest rate, the more willing people are to borrow money to make big purchases, such as houses or cars. When consumers pay less in interest, this gives them more money to spend, which can create a ripple effect of increased spending throughout the economy. Businesses and farmers also benefit from lower interest rates, as it encourages them to make large equipment purchases due to the low cost of borrowing. This creates a situation where output and productivity increase.

Conversely, higher interest rates mean that consumers don't have as much disposable income and must cut back on spending. When higher interest rates are coupled with increased lending standards, banks make fewer loans. This affects not only consumers, but also businesses and farmers, who cut back on spending for new equipment, thus slowing productivity or reducing the number of employees. The tighter lending standards mean that consumers will cut back on spending, and this will affect many businesses' bottom lines. This will cause the businesses to reduce the number of employees that they have and to hold off on any major equipment purchases.

The Effect of Interest Rates on Inflation and Recessions

Whenever interest rates are rising or falling, you commonly hear about the federal fund rates. This is the rate that banks use to lend each other money. It can change daily, and because this rate's movement affects all other loan rates, it is used as an indicator to show whether interest rates are rising or falling.

These changes can affect both inflation and recessions. Inflation refers to the rise in the price of goods and services over time. It is the result of a strong and healthy economy. However, if inflation is left unchecked, it can lead to a significant loss of purchasing power.

To help keep inflation manageable, the Fed watches inflation indicators such as the Consumer Price Index (CPI) and the Producer Price Index (PPI). When these indicators start to rise more than 2-3% a year, the Fed will raise the federal funds rate to keep the rising prices under control. Because higher interest rates mean higher borrowing costs, people will eventually start spending less. The demand for goods and services will then drop, which will cause inflation to fall.

Self chech exercise 4.2	Written test

Instruction: give short answer for the following questions

1explain the term inflation

Score = ___________
Rating: ____________

Answer Sheet

Name: _________________________ Date: _______________

Short Answer Questions

watches inflation indicators such as the Consumer Price Index (CPI) and the Producer Price Index (PPI). When these indicators start to rise more than 2-3% a year, the Fed will raise the federal funds rate to keep the rising prices under control. Because higher interest rates mean higher borrowing costs, people will eventually start spending less. The demand for goods and services will then drop

4.3The impact of changes in ***consumer activity*** on Ethiopian economy

Ethiopia’s location gives it strategic dominance as a jumping off point in the Horn of Africa, close to the Middle East and its markets. Bordering Eritrea, Somalia, Kenya, South Sudan, and Sudan, Ethiopia is landlocked, and has been using neighboring Djibouti's main port for the last two decades. However, with the recent peace with Eritrea, Ethiopia is set to resume accessing the Eritrean ports of Assab and Massawa for its international trade.

With about 109 million people (2018), Ethiopia is the second most populous nation in Africa after Nigeria, and the fastest growing economy in the region. However, it is also one of the poorest, with a per capita income of $790. Ethiopia aims to reach lower-middle-income status by 2025.

Ethiopia’s economy experienced strong, broad-based growth averaging 9.9% a year from 2007/08 to 2017/18, compared to a regional average of 5.4%. Ethiopia’s real gross domestic product (GDP) growth decelerated to 7.7% in 2017/18. Industry, mainly construction, and services accounted for most of the growth. Agriculture and manufacturing made lower contribution to growth in 207/18 compared to the previous year. Private consumption and public investment explain demand-side growth, the latter assuming an increasingly important role.

Higher economic growth brought with it positive trends in poverty reduction in both urban and rural areas. The share of the population living below the national poverty line decreased from 30% in 2011 to 24% in 2016. The government is implementing the second phase of its Growth and Transformation Plan (GTP II) which will run to 2019/20. GTP II aims to continue expanding physical infrastructure through public investments and to transform the country into a manufacturing hub. GTP II targets an average of 11% GDP growth annually, and in line with the manufacturing strategy, the industrial sector is set to expand by 20% on average, creating more jobs.

Development Challenges

Ethiopia’s main challenges are sustaining its positive economic growth and accelerating poverty reduction, which both require significant progress in job creation as well as improved governance. The government is devoting a high share of its budget to pro-poor programs and investments. Large scale donor support will continue to provide a vital contribution in the near-term to finance the cost of pro-poor programs. Key challenges are related to:

- Limited competitiveness, which constrains the development of manufacturing, the creation of jobs and the increase of exports.
- An underdeveloped private sector, which would limit the country's trade competitiveness and resilience to shocks. The government aims to expand the role of the private sector through foreign investment and industrial parks to make Ethiopia's growth momentum more sustainable.
- Political disruption, associated with social unrest, could negatively impact growth through lower foreign direct investment, tourism and exports.

Last Updated: Sep 26, 2019

Reference

https://www.worldbank.org/en/country/ethiopia/overview

Self check exercise	Written test

Instruction: give short answer for the following questions

1define Higher economic growth brought

Score = ___________
Rating: ____________

Answer Sheet

Name: _________________________ Date: _______________

Short Answer Question

investment explain demand-side growth, the latter assuming an increasingly important role.

Higher economic growth brought with it positive trends in poverty reduction in both urban and rural areas

This learning guide is developed to provide you the necessary information regarding the following content coverage and topics:

. Describing the role of regulators

- Identification of The ***main regulator*** of the financial system
- Explanation of The role of each regulator in protecting investors and consumers

This guide will also assist you to attain the learning outcome stated in the cover page. Specifically, upon completion of this Learning Guide, you will be able to –.

- Describe what is meant by the Ethiopian financial markets
- Explain the function and role of the National Bank of Ethiopia (NBE)
- Explain Ethiopia's monetary system
- Explain the key factors that influence the Ethiopian economy
- Describe the role of regulators

Learning Instructions:

1. Read the specific objectives of this Learning Guide.
2. Follow the instructions described below.
3. Read the information written in the "Information Sheet". Try to understand what are being discussed. Ask you teacher for assistance if you have hard time understanding them.
4. Accomplish the "Self-check" in page __.
5. Ask from your teacher the key to correction (key answers) or you can request your teacher to correct your work. (You are to get the key answer only after you finished answering the Self-check).

What Are Regulatory Agencies?

A **regulatory agency** is a governmental body that is created by a legislature to implement and enforce specific laws. An agency has quasi-legislative functions, executive functions, and judicial functions.

The Role of Regulatory Agencies

If you own a business, you probably know it is subject to a cornucopia of laws. Your business is subject to laws that govern social and economic matters, including income taxation, payroll taxation, environmental laws, occupational health and safety laws, real estate law, employment laws, criminal laws, and laws that are specifically related to your particular industry, such as insurance or transportation. The list can go on and on. So, what does this have to do with regulatory agencies?

Regulatory agencies serve **two primary functions** in government: they implement laws and they enforce laws. **Regulations** are the means by which a regulatory agency implements laws enacted by the legislature. You can think of regulations as formal rules based upon the laws enacted by a legislature that govern specific social or economic activities.

Implementing Laws

Regulatory agencies use a specific procedure to create and implement regulations. We'll use the federal process as an example:

5.1 Identification of The *main regulator* of the financial system

Financial regulation is a form of regulation or supervision, which subjects financial institutions to certain requirements, restrictions and guidelines, aiming to maintain the integrity of the financial system. This may be handled by either a government or non-government organization. Financial regulation has also influenced the structure of banking sectors by increasing the variety of financial products available. Financial regulation forms one of three legal categories which constitutes the content of financial law, the other two being market practices, Regulatory agencies are typically a part of the executive branch of the government and have statutory authority to perform their functions with oversight from the legislative branch. Their actions are generally open to legal review.

Regulatory agencies deal in the areas of administrative law, regulatory law, secondary legislation, and rulemaking (codifying and enforcing rules and regulations and imposing supervision or oversight for the benefit of the public at large). The existence of independent regulatory agencies is justified by the complexity of certain regulatory and supervisory tasks, and the drawbacks of political interference. Some independent regulatory agencies perform investigations or audits, and other may fine the relevant parties and order certain measures. In a number of cases, in order for a company or organization to enter an industry it must obtain a license to operate from the sector regulator. This license will set out the conditions by which the companies or organizations operating within the industry must abide.

Functioning

In some instances, regulatory bodies have powers to require that companies or organizations operating within a particular industry adhere to certain standards or deliver a set of outputs *ex ante*. This type of regulation is common in the provision of public utilities which are subject to economic regulation. Regulatory bodies in this area will:

- require individuals, companies or organizations entering the industry to obtain a license;
- set price controls;
- accept filing of tariffs specifying rates and types of services to be provided; and
- require the provision of particular service levels.

In most cases, regulatory agencies have powers to the use some of the following *ex post* mechanisms:

- require transparency of information and decision-making on part of the regulated company or organization;
- monitor the performance and compliance of the regulated company or organization, with the regulator publishing the findings of its investigations;
- require that administrators give reasons explaining their actions, and have followed principles that promote non-arbitrary and responsive decisions;
- undertake enforcement action, such directing the company to comply through orders, the imposition of financial penalties and/or the revocation of a license to operate; and
- arrangements for review of administrative decisions by courts or other bodies such as competition authoriti

Instruction: give short answer for the following questions

1explain the financial regulation

Answer Sheet

Score = ___________

Rating: ____________

Name: _________________________ Date: _______________

Short Answer Question

Financial regulation is a form of regulation or supervision, which subjects financial institutions to certain requirements, restrictions and guidelines, aiming to maintain the integrity of the financial system

5.2 Explanation of The role of each regulator in protecting investors and consumers

1 Financial regulations are laws that govern banks, investment firms, and insurance companies. They protect you from financial risk and fraud. But they must be balanced with the need to allow capitalism to operate efficiently.
2 As a matter of policy, Democrats advocate more regulations. Republicans promote deregulation.

3 Why Financial Regulations Are Important

4 Regulations protect customers from financial fraud. These include unethical mortgages, credit cards, and other financial products.
5 Effective government oversight prevents excessive risk-taking by companies. Regulations would have kept the Lehman Brothers failure from catching the government off-guard.
6 Laws like the Sherman Anti-Trust Act prevent monopolies from abusing their power. Unregulated monopolies gouge prices, sell faulty products, and stifle competition.
7 Without regulation, a free market will create asset bubbles. That occurs when speculators bid up the prices of stocks, houses, and gold. When the bubbles burst, they create crises and recessions.
8 Government protection can help some critical industries get started. Examples include the electricity and cable industries. Companies wouldn't invest in high infrastructure costs without governments to shield them. In other industries, regulations can protect small or new companies. Proper rules can foster innovation, competition, and increased consumer choice.
9 Regulations protect social concerns. Without them, businesses will ignore damage to the environment. They will also ignore unprofitable areas such as rural counties.

The fast pace of financial innovation has created a complex world for consumers, where the range of available financial products is broad, and the consequences of financial choices are significant. Coupled with this, the typical household tends to have a limited personal track record in making financial decisions, since the purchase of financial products happens only infrequently. This is problematic, since the demands for financial sophistication and knowledge are sizeable if a consumer is to navigate safely through the options put forward by providers of financial services. Financial decisions often require consumers to assess risk and uncertainty, for example, and to consider trade-offs between the near term and the long term. A growing body of academic literature shows that, among the general population, the level of financial knowledge, skills and ability to consider such complexities is low.[2]

There is also a growing body of evidence from the field of behavioral economics that consumers are subject to behavioral biases when making decisions. In other words, decisions are affected by emotions and psychological experiences, by rules of thumb and accepted norms. For example, consumers can exhibit present-biased behavior, which leads them to over-value payoffs today relative to payoffs in the future, a bias which can be associated with self-control problems.[3] In addition, households can be overly attached to the status quo and suffer inertia bias, taking default options in financial contracts, failing to switch product or provider even when there are clear benefits to switching.[4] Retail investors also tend to follow naïve investment strategies rather than identifying superior options.[5] Consumers can also exhibit loss aversion bias, meaning that they care more about potential losses than making equivalent gains.[6]

The design of financial products and services can serve to ease or exacerbate these biases. In this context, behavioral economics shows that framing matters – put simply, firms can present the same information in different ways and this can lead to different choices by consumers. A key insight from the recent experience with financial crisis and from the growing literature on behavioral economics, is that consumers do not always act in their own best interest. In addition, market forces do not always act to reduce consumer mistakes. Firms face their own incentives when designing and framing products, and these incentives may not align with the best interests of the consumer. For example, analysis by the Office of Fair Trading in the UK shows that firms can frame prices in a way that plays on consumer biases.[7] Empirical research also suggests that firms can choose to market the salient features of products that appeal to consumer biases, while shrouding the less favorable aspects that could alter a consumer's choice to purchase that product. [8] The interactions between misaligned incentives and behavioral biases can adversely affect consumer welfare, and there are many examples of analytical work that highlight such costs

Self check exercise 4.3 **Written test**

Instruction: give short answer for the following questions

1Why Financial Regulations Are Important

Answer Sheet

Score = ___________

Rating: ____________

Name: ________________________ Date: ______________

Short Answer Question

Regulations protect customers from financial fraud. These include unethical mortgages, credit cards, and other financial products.

Effective government oversight prevents excessive risk-taking by companies. Regulations would have kept the Lehman Brothers failure from catching the government off-guard.

Laws like the Sherman Anti-Trust Act prevent monopolies from abusing their power. Unregulated monopolies gouge prices, sell faulty products, and stifle competition.

Without regulation, a free market will create asset bubbles. That occurs when speculators bid up the prices of stocks, houses, and gold. When the bubbles burst, they create crises and recessions.

Reference

https://www.thebalance.com/financial-regulations-3306234