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NATIONAL BANK OF ETHIOPIA

PRESS RELEASE

THE NATIONAL BANK OF ETHIOPIA ANNOUNCES A REFORM OF THE FOREIGN EXCHANGE REGIME WITH IMMEDIATE EFFECT

29 July 2024 | Addis Ababa, Ethiopia

Following up on the Government's recent statement regarding Ethiopia's economic reform program, the National Bank of Ethiopia is announcing a major revision of the country's foreign exchange (FX) system effective immediately. The reform introduces a competitive, market-based determination of the exchange rate and addresses a long-standing distortion within the Ethiopian economy. The implementation of the reform will be guided by a new Foreign Exchange Directive (FXD/01/2024) being released today.

Ethiopia's foreign exchange reform is just one part of a wider package of economic reforms that are being implemented and accelerated over the coming months. The package of reforms—based on the country's Home-Grown Economic Reform Plan (HGER 2.0)—aim to restore macroeconomic stability, boost private sector activity, and ensure sustainable, broad-based, and inclusive growth.

Key Elements of Ethiopia's foreign exchange reforms

The foreign exchange reforms being announced today involve significant new policy changes in the following areas:

1. **A shift to a market-based exchange regime,** whereby banks are henceforth allowed to buy and sell foreign currencies from/to their clients and among themselves at freely negotiated rates, and with the NBE making only limited interventions to support the market in its early days and if justified by disorderly market conditions.
2. **The end of surrender requirements to the NBE,** allowing foreign exchange to be retained by exporters and commercial banks and thus substantially boosting FX supplies to the private sector.
3. **The removal of import restrictions that previously prohibited 38 product categories** and the broader liberalization of the foreign exchange market for the imports of goods and services, while capital account outflows remain restricted as before.
4. **The improvement of retention rules** allowing exporters to retain 50 percent of their foreign exchange proceeds vs 40 percent previously.
5. **The complete removal of rules governing banks' allocation of foreign exchange** that was based on a waiting list system for different categories of imports.
6. **The introduction of non-bank foreign exchange bureaus** that are henceforth free to engage in the buying and selling of foreign currency cash notes at market rates.
7. **The removal of restrictions on franco valuta imports,** to be implemented shortly through an upcoming regulation.
8. **The simplification of rules governing foreign currency accounts,** especially those currently held by foreign institutions, FDI companies, and the Diaspora.

9. **The allowance for residents to open foreign currency accounts**, based on remittance inflows, transfers from abroad, FX-based salary or rental income, and for other specified cases, as well as the ability to use such foreign currency accounts for foreign service payments.
10. **The removal of interest rate ceilings that previously applied to private sector companies or banks** when borrowing from abroad.
11. **The opening of Ethiopia's securities market to foreign investors,** with the terms and conditions to be specified further in the near future.
12. **The granting of special foreign exchange privileges to companies within Special Economic Zones**, including the ability to retain 100 percent of their foreign exchange earnings.
13. **The relaxation of various rules on the amount of foreign currency cash notes travelers may carry** when travelling into or out of Ethiopia.

The FX reforms summarized above represent a comprehensive set of measures that will support Ethiopia's current stage of development and its increasing integration with the rest of the world. These reforms are consistent with longstanding Government intentions outlined in key policy documents, which recognized that Ethiopia should eventually move towards a market-based foreign exchange system as its economy grows in complexity and evolves over time. While such reform was delayed thus far due to a combination of external and internal factors, the start of a new budget year and the successful re-engagement with key external partners provide a window of opportunity for embarking on this exchange rate reform.

Why FX Reform?

The reform in the exchange rate system being introduced today is challenging in several respects but at the same time critically necessary. The prevailing foreign exchange rate system, though initially meant to help ensure a stable exchange rate and low inflation, has instead resulted in the emergence of an unanchored parallel market exchange rate together with high inflation. The current system has given rise to large-scale contraband exports of Ethiopia's precious resources and diverted the country's foreign exchange earnings away from both the formal banking system and the domestic economy. All of this has improperly benefitted a few illegal actors and middlemen at the expense of Ethiopia's productive sectors, which face chronic and acute foreign exchange shortages. Some of Ethiopia's most dynamic businesses and entrepreneurs have thus suffered significantly as a result, undermining policy efforts to expand exports, boost manufacturing, attract further foreign investment, and establish a stronger FX position.

By shifting to a market-based determination of the exchange rate, a number of widespread economic benefits can and will be realized:

- **First, FX reform will benefit millions of Ethiopians in multiple FX-generating sectors.** Key beneficiaries will include: millions of farmers involved in the production of exportable crops (coffee, sesame, pulses, flowers, fruits, vegetables, chat); pastoralists and livestock owners exporting cattle and meat; tens of thousands of artisanal and formal miners engaged in mining activities, particularly of gold; hundreds of thousands of manufacturing sector employees in exportable sectors; thousands of business engaged in the services and tourism sectors (especially those catering to international visitors); millions of individuals who regularly receive remittances from relatives living abroad; and also hundreds of NGOs and private institutions who receive financing from external sources. Beyond these direct beneficiaries, the business partners, suppliers, and dependents associated with all of the above entities also stand to benefit, further broadening the pool of reform beneficiaries.

- **Second, FX reform will help ensure that Ethiopia's foreign earnings potential is properly captured and repatriated for the benefit of its residents and productive sectors.** Current exchange rate policies have encouraged the smuggling of exports, under- and over-invoicing practices by exporters and importers, as well as capital flight—all of which prevent Ethiopia from realizing its large FX-generating potential and divert valuable resources away from the local economy and the many domestic businesses that critically need it.

- **Third, FX reform will provide a major boost to Ethiopia's growing import-substituting industries**, offering industries in this space an opportunity to scale up their operations and capture significant market share. Import substituting industries in the consumer and industrial sectors will be particularly important beneficiaries, in line with the "*Ethiopia Tamrit*" initiative currently being promoted for multiple local industries.

- **Fourth, FX reform will complement numerous *other* reform measures taken in recent years to promote the private sector**. Among others, such measures have included the opening up of sectors previously closed to private/foreign investors (telecom, logistics, banking, capital markets, wholesale/retail trade), ease of doing business reforms, the start of private sector participation in public sector projects (via PPPs), the introduction of Special Economic Zones, and much more. While reforms in the above areas opened up numerous opportunities for the private sector and for driving future growth, foreign exchange policies remained a serious impediment in some cases and were thus in need of correction.

- **Fifth, FX reform will improve Ethiopia's attractiveness to foreign investors, thus providing a big boost to FDI inflows and aligning our business environment with those of our neighbors and peers.** At present, Ethiopia stands out among Africa's largest economies and among many emerging markets for having a regulated exchange rate system marked by controls and FX supply shortages. Accordingly, while Ethiopia's investment attractiveness is strong on numerous dimensions—a large population size, educated work force, widely available and competitively priced inputs (labor, land), good air connectivity, improving logistics, and plentiful supplies of energy, natural resources, and minerals—all these advantages have been undermined by a very restrictive FX regime. Putting in place a more conducive FX regime removes what has been seen as a major deterrent by foreign investors and should deepen FDI interest and activity in Ethiopia.

- **Sixth, FX reform will help address many long-standing business practices that encouraged informality and illegality in the economy.** The current exchange rate regime has reduced incentives for foreign exchange to come into the country through formal/banking channels and also increased incentives for FX-earning companies/individuals to keep foreign exchange out of the country. The use of parallel market exchange rates has also taken root in several segments of the economy, such that for many parts of the private business community as well as for remittance senders/beneficiaries, transactions are already taking place at parallel market exchange rates. The FX reform being implemented today recognizes this market reality and will work to discourage such informal practices from here on with a switch expected towards the use of formal channels that can offer competitive and convenient modes of transaction.

In summary, FX reform is essential to address acute foreign exchange shortages, enhance export competitiveness, attract FDI, and complement multiple other macroeconomic reforms that are being put in place to enhance conditions for private sector enterprises to grow and thrive in the Ethiopian economy.

Additional Measures

The Government has made careful and comprehensive preparations to ensure an orderly transition to the new exchange rate system.

- **First, the Government has decided to temporarily subsidize certain essential imports**. In this respect, through the use of temporary subsidies and a gradual pass-through of prices, the Government has decided to minimize the full price impacts on essential import items such as fuel, fertilizers, medicine, and edible oil. This measure will help millions of urban residents, millions of farmers, and large population segments reliant on these critical imported commodities.

- **Second, financial support is being enhanced for those whose real incomes have been eroded due to high inflation in recent years.** To help address past and anticipated inflation impacts, Government intends to supplement civil servant salaries in a manner that can be financed by available resources and without significantly worsening the budget deficit. Also, funding for Ethiopia's Productive Safety Net Program (PSNP), which covers low-income rural and urban beneficiaries, is being expanded substantially to support close to ten million families. The details of these measures will be provided by the Ministry of Finance.

- **Third, debt service relief is being secured by Government to preserve budgetary allocations for social and capital spending** and to ensure that the higher local currency cost of external debt service does not crowd out other expenditure. By arranging for such debt relief in advance, Government will substantially reduce its near-term external debt service obligations and instead increase its developmental expenditures both for this and subsequent fiscal years.

Beyond the specific mitigating measures above, the National Bank of Ethiopia and the Ministry of Finance are enhancing their coordination to manage the transition to a new exchange rate regime and ensure sound monetary and fiscal policies in the immediate period ahead. More specifically:

- **The NBE has initiated new tools to conduct monetary policy and reduce inflation**: Following up on measures put in place last year to limit credit growth, the NBE has recently introduced an interest-rate based monetary policy regime that will help better manage monetary and credit developments in a way that is responsive to inflation and exchange rate developments.

- **The Ministry of Finance is enacting measures to build a stronger revenue base,** which in turn will make it possible to increase spending without the use of highly inflationary forms of financing such as Direct Advances from the NBE to the Government.

Finally, helping mitigate the transitional costs and impacts of FX reform will be a financial package of $10.7bn offered by Ethiopia's external partners to support our reform—the single biggest ever coordinated commitment of support by international partners towards Ethiopia. This support includes exceptional financing from the IMF, the World Bank, and Creditors. This excludes $2.8bn in bilateral support in the form of central bank deposits and swap lines as well as further financing from the World Bank, IFC, and other multilateral institutions that will be announced by the respective institutions in due course. Given the strength of the Government's reform package, the IMF and World Bank are both providing exceptional and front-loaded funding support that will be among their highest such allocations in the African continent.

Looking Ahead

The implementation of this foreign exchange reform—together with other macroeconomic policy measures as well as international support—provides a truly unique opportunity for Ethiopia to accelerate its growth and developmental trajectory over the coming years. Indeed, as long-standing bottlenecks and binding constraints are removed, we expect no less than a major economic take-off for the Ethiopian economy in the next few years. Per the IMF's macroeconomic assessment, our package of economic reforms being implemented in Ethiopia is expected to further accelerate growth, gradually reduce inflation (after a temporary increase), increase fiscal space to allow for higher social and capital spending, and significantly raise exports, FDI, and the country's foreign exchange reserves. Based on IMF forecasts for the next four-year period, the package of reforms being implemented could sustain annual growth of near 8 percent, reduce inflation to 10 percent, raise fiscal revenue to 11% of GDP, reduce debt to 35% of GDP, increase goods and services exports to $20bn, boost FDI to $6bn, and enable foreign exchange reserves to reach $10bn (equivalent to 3.5 months of import cover). These are indicative projections based on implementation of the policy package outlined above and provide a perspective on the scale of economic transformation possible over the coming years.

For the immediate weeks and months ahead, the NBE will be focused on ensuring a successful transition to the new foreign exchange regime—while pursuing its core price stability mandate. To help in both these tasks, NBE will be conducting regular press briefings and updates in the initial weeks of reform to share all the requisite information and data needed by the public and the foreign exchange market in this period of transition. Among the specific updates to be provided will be:

- Updates on the Indicative Daily Exchange Rate based on the previous day's FX market transactions.
- Information on any foreign exchange auctions conducted by the NBE, including data on aggregate volumes, number of participants, and transaction exchange rates.

- Information on any notable market developments, disruptions, misinformation or other issues that merit a formal response.
- Explanations and clarifications that may be needed on the new Foreign Exchange Directive on the part of banks, customers, and the broader public.

NBE will also pay special attention to its monitoring, surveillance, and inspection responsibilities over the coming months. As a large share of FX market responsibilities is now being delegated to banks, NBE will expect their strict adherence to the new FX Directive, particularly in ensuring that their FX allocations are for bona fide current account transactions and are not channeled to prohibited capital account outflows. Banks are also expected to strictly adhere to export retention rules, daily net open position limits, daily exchange rate reporting requirements, and Anti-Money Laundering responsibilities. Any collusive behavior in the setting of exchange rates or service fees shall also be prohibited. NBE will use the full range of available tools at its disposal to fulfil these oversight responsibilities—including the use of IT-supported FX transaction monitoring capabilities and collaboration with financial intelligence and law enforcement agencies as may be needed.

In closing, as Ethiopia marks this transformative moment in its economic journey to becoming among Africa's most vibrant, open, and competitive economies, NBE calls upon all key players in the foreign exchange, banking, and business community as well as the broader public to play their part in making this reform a genuine success for the benefit of all Ethiopians.