



Policy Brief:

Analysis of the Implications of Foreign Exchange Reforms on Food Prices in South Sudan

September 2021





Abstract

UNDP and WFP² collaborated to produce this technical brief reflecting on the impact of foreign currency exchange and reforms on food prices. **The brief targets the following audience i. Food, Security and Livelihood cluster ii. Government Sector Working Groups and iii. Juba Economists Group.**

The economy of South Sudan is one of the most oil-dependent economies in the world. The economy's dependence on one commodity (oil) makes it highly susceptible to external shocks. Therefore, the most obvious socio-economic impact of the pandemic in South Sudan is on the reduced fiscal space because of low oil prices in the global market. The secondary impact, in addition to low oil prices, is that the economy experienced, for the past two years, sharp and fast depreciation of the SSP and government's fiscal expansionary response by borrowing from the Central Bank (instead of cutting down on expenditure) resorted to high inflation for an import-dependent country. Coupled with the impact of the pandemic, South Sudan's economy is also vulnerable to weather and conflict-related shocks. As the country and the entire world battled with mitigating the impact of the pandemic, the Government of South Sudan and development partners introduced measures to reverse the trend of depreciation of the SSP by implementing several forex reforms. These reforms are bearing fruits with regards to the appreciation of the SSP and closing the gap between the exchange rate at the parallel market and the official exchange rate. Of most importance to South Sudan's poor, who constitute about 82¹ percent of the population, is the impact of these circumstances on food prices. For an import-dependent country, expectations are that the appreciation of the SSP will translate into a reduction of prices in general, especially for imported food. There is growing concern that this is not the case.

This technical brief analyzes the delay in the translation of currency appreciation into reduced food prices as food accounts for a very significant proportion of households' expenditure. The brief is divided into five parts and will analyze exchange rate reforms and implications for South Sudan's economy with a focus on food prices. The first section is an introduction; section two discusses the drivers and the trends of the exchange rate in South Sudan's recent past. Section three discusses the implication of the exchange rate on different sectors of South Sudan's economy. Section four focuses on food price analysis, and section five concludes the brief. The brief covers the period from the onset of the COVID-19 pandemic in 2020 to the present.

¹ About 82% of the population in South Sudan is poor, according to World Bank estimates, based on the \$1.90 2011 purchasing power parity (PPP) poverty line, up from 51% in 2011. <https://www.worldbank.org/en/country/southsudan/overview> published 2nd April 2021. Accessed on 21st September, 2021

² The policy brief is prepared by the Strategy, Policy, and Capacities for Economic Management team at UNDP and the Vulnerability Analysis and Mapping team as WFP.* Our thanks go to Mr. Samuel Doe (UNDP, Resident Representative), Matthew Hollingworth (WFP, Representative and Country Director), Ms. Adeyinka Badejo (WFP, Deputy Country Director) for their endorsement of the initiative, leadership and constructive feedback and support.

Section 1: Introduction - The Economic Context

Currency depreciation/appreciation is one of the macroeconomic indicators of economic stability or otherwise. The relationship between exchange rate movement and local prices given a dynamic economy is central for economic stability and a key measure which is the thrust of this brief. The motivation to analyze this relationship is since the onset of the COVID-19 crisis and even before, the SSP depreciated at a fast pace against the US dollar. Of significant concern is the differential rate between the official and the parallel markets. Understanding the implications of foreign exchange reforms on food prices requires an understanding of the context within which the rapid depreciation of the SSP occurred and to situate the same within the broader economic context in the country. The IMF South Sudan Country Report in 2020 highlights the challenging context that prevailed before the onset of the pandemic:³ about 40 percent of the population are either internally displaced or live as refugees in neighboring countries and more than half of the population (nearly 7 million people) require humanitarian assistance and are acutely food insecure. The health sector is extremely weak and largely reliant on the support of the donor community, and its capacity to absorb the shock of the pandemic is extremely limited. The poverty rate is estimated to be over 80 percent. The country is heavily dependent on oil, which represents 97 percent of its exports and 88 percent of the government's revenues. With almost total dependence on oil, the problem is not so much the structure of the economy but the lack of commitment to diversify and most importantly the prudent (or not) use of oil revenues is critical in changing the situation.

The economic data reflect the country's difficulties. For example, in FY 2019/2020, average inflation was 35 percent. The exchange rate was massively over-valued with the official rate at SSP 161 to the dollar and the parallel rate of SSP 306 to the dollar. Real GDP grew 13.2 percent (from a deflated base) while reserve money increased by 41.2 percent (hence the inflation). The current account balance, excluding grants, on the external accounts was -25.8 percent of GDP. Including grants, the balance was -4.5 percent of GDP. Total debt was equivalent to 40.8 percent of GDP and because of the lack of foreign reserves (around 3 days of imports coverage, i.e., ~US\$41 million) and the limited prospects for rapid recovery in GDP or exports, the country was at "high risk of debt distress."⁴ The government budget is seriously imbalanced. The budget deficit was 7.2 percent of GDP with 3.3 percent of GDP in external financing and 4.2 percent of GDP in internal financing. The latter was in the form of central bank credit which accounted for the rapid growth of reserve money (as noted 41.8 percent) and almost equally rapid average inflation (again, as noted, 35 percent).

Maintaining a competitive exchange rate requires policies to (broadly) align domestic absorption with domestic income and to ensure that the financial system is market-driven and appropriately supervised. Keeping domestic inflation in line with comparable international rates involves paying close attention to the public sector deficit (government and public enterprises), the rate of monetary expansion, and fiscal/regulatory policies which stimulate local enterprise and entrepreneurship.

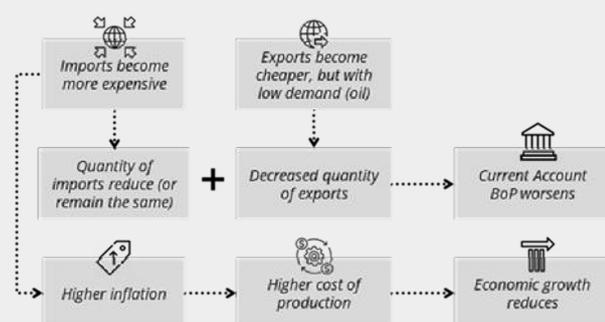


³ IMF 2020, p.3

⁴ IMF 2020, pp.8, 13, 22, Annex 1

Section 2: The Exchange Rate: Drivers and Recent Trend

South Sudan has been hard hit by the COVID-19 pandemic secondary effect of lowering international oil prices. These challenges have led to an urgent balance of payments and fiscal financing needs and reversed early economic gains from political stability achieved with the formation of the Revitalized Government of National Unity in February 2020. According to the World Bank, the economy of South Sudan had picked up before the pandemic with a GDP growth rate of 9.5 percent in 2019/2020 financial year⁵; largely driven by strong oil prices. The pandemic blotted this picture as deterioration of living standards was observed as the pandemic raged. The first sign of COVID-19's impact on the economy was the fall in foreign reserves (reference is made to the announcement of the Governor of the Central Bank of South Sudan (BSS), who declared publicly by July 2020 the country was running out of reserves), government increased its borrowing and spending, the exchange rate depreciated and the general rise in prices (inflation) ensued. This relationship is represented in the diagram below showing the impact of depreciation of the SSP on imports, higher inflation, and reduction in economic growth. The relationship also shows how more expensive imports have negatively impacted and worsen the balance of payment account.



By mid-2020, information on dwindling reserves was slowly beginning to cause panic in the market amid a big wedge in the differences between the government official exchange rate (which was used by government and state-owned entities who based all their transactions on the official rate causing significant distortions in the market) and the rate in the parallel market. At this point, the government constituted an Economic Crisis Management

Committee (ECMC) to stimulate the economy and provide recommendations on increasing domestic non-oil revenue. Some gains were noted as government began to record increases in non-oil revenue mobilization. However, the measures introduced by the ECMC did not necessarily focus on 'fixing' the exchange rate challenge.

In support of a Public Financial Management (PFM) reform process initiated by the government, the International Monetary Fund (IMF) approved South Sudan's request to access about 30 percent of the Special Drawing Rights (\$52 million) through the Rapid Credit Facility (RCF) towards the end of 2020. Most of these funds were auctioned in the foreign exchange market in a bid to increase the supply of dollars with the hope of easing prices of imported goods and increasing the supply of the same. In early 2021, the IMF's emergency financing under the Rapid Credit facility was once again triggered to help meet priority spending needs, catalyze donor support, and foster critical economic reforms envisaged under a Staff-Monitored Program. The IMF approved a disbursement of about \$174.2 million to South Sudan in the March 2021 RCF. Most recently, in August 2021, the IMF has approved allocation of Special Drawing Rights (SDRs) equivalent to \$334 million. The disbursement is expected to help finance South Sudan's urgent balance of payment needs⁶ and provide critical fiscal space to maintain poverty-reducing and growth-enhancing spending.

Following the approval of the \$174 million RCF disbursement from the IMF in [March 2021], the Central Bank of South Sudan continued to auction dollars on the foreign exchange market. Since December 2020, the Central Bank auctioned about \$2 million every two weeks to FOREX bureaux and an additional \$3 million to commercial banks⁷. Due to the huge reliance on imports in South Sudan, the injection of dollars from the RCF funds alone is unlikely to meet the country's import needs. However, the auction created a dollar supply that has contributed to a convergence between the parallel and official exchange rates. Although not obvious, the convergence of the two exchange rates must have

5 <https://www.worldbank.org/en/country/southsudan/overview>, April 2, 2021 Accessed on 21st September, 2021.

6 <https://www.imf.org/en/News/Articles/2021/03/31/pr2194-south-sudan-imf-execboard-approves-us-174-2m-emergency-assistance-address-covid19>

7 <https://www.voanews.com/africa/south-sudan-focus/south-sudan-secures-174-million-imf-loan>

been influenced by other factors. The collapse of effective local demand, partly because of the floods⁸, but also salary arrears, meant that most of the population of South Sudan experienced a reduction in purchasing power that reduced their consumption and increased reliance on development partners (increased humanitarian needs). This decline of real economic activity (observed in the deterioration of living standards) could translate in lower demand of imported goods hence lower demand for foreign exchange.

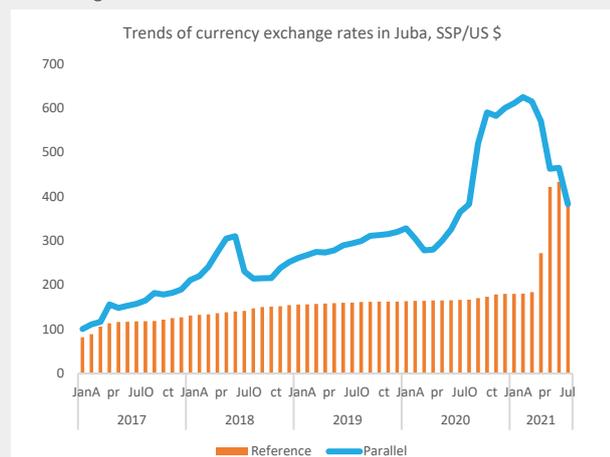


Figure 1. Trends of exchange rate. Source: WFP, Bank of South Sudan

Since April 2021, the Central Bank of South Sudan has been auctioning a total of US\$3 million every two weeks to commercial banks in a bid to revive the declining economy. According to sources from commercial banks, bidders can buy a maximum of 15 percent of the total foreign currency available for auction, amounting to \$750,000. Commercial banks in turn sell the foreign currency bought from the auction to their customers, based on a first-come-first-served basis. However, there are no criteria set forth to buy dollars from commercial banks. Some banks indicated that they prioritize customers who have bank accounts with them. In terms of sufficiency of the dollar, different opinions were received from the banks – some of the banks indicated that the dollar supply is sufficient to meet the demands of their customers for two weeks, while others pointed to insufficiency.

From April to July, the applicable exchange rate was based on the official rate set by the Central Bank of South Sudan, which was lower than market value. However, the Central Bank has gradually unified the exchange rates and introduced a market-based exchange rate in July 2021. This was long overdue but welcomed approach as suggested as one of the policy options in a UNDP-led analytical brief prepared

by the UN Joint Analysis Team⁹. The auction has helped traders to access dollars at a lower rate (April to July) and has contributed to the appreciation of the local currency in the parallel market. According to WFP's assessment in Juba, contacted traders have explained their access to dollars from commercial banks or forex bureaus at the reference rate, plus profit margins charged by the banks. For instance, during the first week of July 2021, KCB was buying dollars at SSP 331 and was selling at SSP 371, while EcoBank was selling at SSP 335 per dollar. However, some traders still buy dollars from the parallel market to avoid bureaucracy at the banks. There could be underlying factors by traders who continued to buy from the parallel market instead of showing up at commercial banks and accessing at a lower rate. The first, as pointed out, is cumbersome processes at the banks which should be streamlined to ensure sustainability of the unified rates. Following the injection of dollars, the SSP has gained momentum and the exchange rate in the Juba parallel market appreciated, reaching the highest at SSP 340 per dollar during the first week of July¹⁰. The real challenge for economic stability is how to ensure that the two rates do not diverge. General opinion holds that this is expected to happen given that, in the first place, the convergence was driven primarily by using IMF-provided RCF resources. More is expected from the Central Bank to ensure they resist from guiding the direction of the exchange rate (and allow the market forces to prevail). The Central Bank should also ensure that the exchange rate stabilizes, and no further appreciation occurs; this includes learning from options that other countries adopted which entail buying up any excess forex which is putting upward pressure (appreciation) on the exchange rate. This is one way through which the Central Bank will begin to slowly build reserves that can provide a cushion for any distortions in the market.

In July 2021, the average exchange rate in the parallel market stood at SSP 383, equivalent to the rate one year ago, in August 2020. By contrast, the official exchange rate depreciated, as compared to April 2021, by 37 percent (from SSP 272 to 433) and by 62 percent in June 2020 (dropped from SSP 166 to 433). Since the introduction of unified exchange rate (market rate) the difference between banks and parallel rates has been cleared.

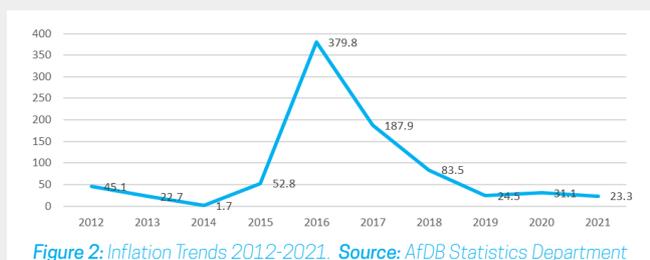
The data about inflation is presented below to juxtapose the effect of foreign exchange on food

8 Over one million people were affected by floods between July 2020 and January 2021. Floods affected people's urgent needs such as food, livelihood support, shelter etc. See <https://reliefweb.int/report/south-sudan/south-sudan-flooding-situation-report-inter-cluster-coordination-group-31-january>

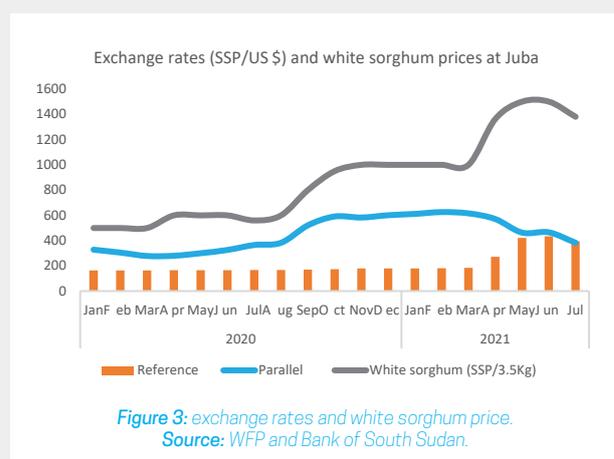
9 Analytical brief: SSP depreciation in South Sudan, UN Joint Analysis Team, February 2021.

10 In Juba parallel market, the from December 2020 to March 2021, the exchange rate plummeted at a historical low - ranging from 600 to 625 and reached the lowest rate in February 2021, at 625/US\$.

prices. There was a sharp increase in annual prices between 2019 and the onset of the pandemic in 2020. Inflation rose by almost 7 percent between 2019 and 2020. However, by 2021, as oil prices in the global market picked up, as positive gains from foreign exchange reforms begin to bear fruits, annual inflation has dropped by almost 8 percent. Initial reflection could point to this reaction of the market being from a supply side and not so much on increase in economic activities. One could also speculate possible increase in economic activities given the payment of salary arrears for which government indicated they have cleared all salaries besides one month, by July 2021. It is however important to use month-to-month Consumer Price Index (CPI) data where possible to assess the annual inflation figures to see how this reflects local economic expansion activities as against the increase in the flow of imports. These analyses are important to inform public policy options that government and development partners can apply in a bid to regenerate local economic activity.



On a closer look however, the positive inflation trend did not seem to be reflected in the price of white sorghum, which continued an upward movement from March 2021 after relative stability in price around October 2020 up until February 2021. This period coincides with the peak of the foreign exchange auction. As the momentum of the forex auction picked up, as commercial banks got more and more involved, and as the official exchange rate and the parallel rates converged, stability in the price of sorghum is slowly observed between May and June 2021.



Section 3: The impacts of exchange rate on South Sudan

With the increasing reliance on imports, disruptions caused by the COVID-19 pandemic have placed additional challenges on importing basic items. COVID-19 has resulted in reduced levels of commercial activities due to the long screening process at the borders slowing down movement of commodities and hence limiting trade volume. The limited trade volume translated to reduced non-oil revenue for the government of South Sudan in the second and third quarters of 2020. The slowdown in commodity movement impacts the transport costs and hence exerts pressure on prices that are transferred to consumers. After the lifting of border restrictions in 2020, the emergence of the new COVID-19 Delta variant, forced the government of Uganda, South Sudan's main source of imports, to put forth movement restrictions including lockdowns¹¹ as announced on 4 June 2021.

On the other hand, a sharp decline in international oil prices triggered by the pandemic and devastating floods eroded economic gains. The decline in global oil prices caused a decline in oil revenues, the main source of South Sudan's income. The economic downturn caused by COVID-19 and the decline in oil prices widened the fiscal and the balance of payments deficits, opening large financing gaps in the absence of concessional financing. In the past, the monetization of the fiscal deficit resulted in high inflation and significant exchange rate depreciation, this has been stopped by the government. A modest economic recovery is projected in FY 2021/2022 on the heels of oil price recovery¹² Additionally, devastating floods in several parts of the country undermined agriculture production and exacerbated humanitarian needs for many South Sudanese.

11 <https://www.africanews.com/2021/06/07/uganda-imposes-another-lockdown-what-are-the-restrictions/>

12 <https://www.imf.org/en/News/Articles/2021/03/31/pr2194-south-sudan-imf-execboard-approves-us-174-2m-emergency-assistance-address-covid19>

An appreciation of the South Sudan pound also shows the government collects less from the sale of its dollars. Despite the appreciation of the local currency in the parallel market, the official exchange rate has depreciated by higher than 50 percent in April 2021 as compared to last year in the same month. In his recent speech, the President has promised an increase in salaries for all government employees and to clear all salary arrears.¹³ As the government revenue in local currency from the injection of dollars is expected to increase, it will minimize the burden on the government to cover salaries and other expenditures. It also reduces fiscal space for resources available for financing peace.

Humanitarian organizations who operate in South Sudan, channeling incoming foreign exchange resources through the Central Bank of South Sudan and effecting payments in SSP will be in a better position. However, the degree of the gain depends on the counterbalance between the levels of prices and the advantage obtained from the difference in the exchange rate.

The depreciation of the SSP, continued inflationary pressure coupled with almost zero interest rate at banks have forced moderate to better-resourced households to hold their money in US dollars, at least to maintain their purchasing power. On the other hand, the exchange rate in the last fiscal year, September 2020 and March 2021, fluctuated from SSP 520 to SSP 625. Thus, those who converted their local currency into US dollars must re-convert some of their money into local currency at the current rate. They will be doing the conversion at a disadvantaged rate to purchase items at the time when prices remained at elevated levels or even increased beyond the levels one year ago. Thus, these groups are the losers from the appreciation of the SSP.

If the auction of dollars by the Central Bank of South Sudan becomes sustainable and continues, possibly with more resources, it minimizes the preferential advantage that few were enjoying from easy access to dollars at the official rate, which was by far below the market values, thus removing the rent-seeking advantage and distortion in market prices. Thus, the playing ground becomes fair to everybody and enhances markets competition in the long term for the benefit of the final consumers.

Under normal circumstances, currency appreciation makes imports more attractive, cheaper and expected to bring good fortunes, especially in terms of reduced levels of price for the consumers. According to the CPI data from the National Bureau of Statistics, inflation increased by about 18 percent in June 2021. However, the gains observed in markets in favor of consumers have not been as expected, as prices are generally sticky downwards. The retail prices of staple cereals witnessed stability at their elevated levels and even increasing trends in few locations. It appears traders have little confidence about the sustainability and continuity of the auction and disbursement of foreign currency by the Central Bank of South Sudan. They are speculating that the SSP will depreciate as soon as the funds released from the IMF are exhausted. Thus, they want to maintain the prices of food commodities at an elevated level. However, it is not clear for how long they will continue with this scenario. Overall, this unfolding situation exposed market-dependent households to further economic vulnerability.

More than a third of South Sudanese depend on markets for cereals, according to the Food Security and Nutrition Monitoring Survey (FSNMS, June 2020), with the highest proportion in Upper Nile at 48.3 percent, followed by Northern Bahr el Ghazal (37.6 percent). Additionally, the FSNMS assessment revealed some 37.3 percent of households across the country reported a reduction in their income over the previous year. The same report showed **74 percent of household expenditure was on food**, with expenditure on cereals accounting for 48.6 percent of the total food expenditure in December 2019.

With the combined impact of the above factors coupled with increasing food prices at the time of the exchange rate appreciation, market-dependent households with fixed income sources are the heavily affected segment of the population. More specifically, the urban population who receive their incomes in local currency are the most affected ones. This group includes government employees, daily laborers, private company employees, hotel and restaurant employees, service providers who are paid in local currency, and others in the same category.

Other factors could however be contributing to the elevated levels of food prices in South Sudan. As a net cereal importer, with the highest estimated

13 President Kiir announces 100 percent salary increment for all civil servants <https://www.sudanspost.com/kiir-announces-100-percent-salary-increment-for-all-civil-servants/>

gap documented in 2019 at 518,000 mt and about 464,000 mt cereals gap remaining in 2021, South Sudan is particularly vulnerable to movements in global food prices. According to the Food and Agriculture Organization of the United Nations (FAO), global food prices rose in May 2021 at their fastest monthly rate in more than a decade, even as world cereal production is on course to reach a new record high.¹⁴ Furthermore, the significant logistical challenges in getting imported food commodities

into and across South Sudan could also be a factor causing food prices to stay elevated. Meanwhile, the food gaps in South Sudan have been met through humanitarian food aid and the remaining balance through commercial imports mainly from Uganda and through informal trade from Sudan. As the food gap widens, the total imports of main staples (sorghum and maize) have sharply increased in the last two years, suggesting the significant importance of foreign currency to import food items.

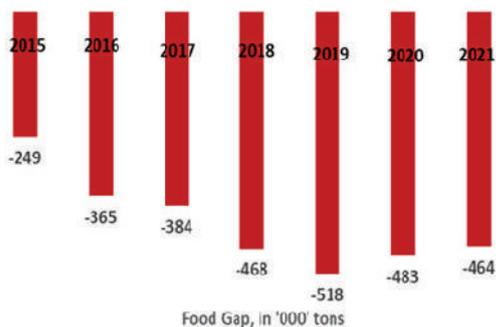


Figure 4: Trends of Food Gap. Source: CFSAM Reports



Figure 5: Trends of imports. Source: FEWS NET

Policy Recommendation

What options does the Government of South Sudan have to change the underlying economic dynamics in ways that will accelerate the country's recovery? Five things stand out:

- > First, do whatever is required to sustain peace. There will be no recovery, let alone growth and development, if the peace agreement dissolves or falls short.
- > Second, seek every opportunity to rekindle local, small-scale economic activity through the revival of agriculture and herding, micro-, small, and medium-scale enterprises, particularly transport and logistics, and food/commodity processing. The Government should also ensure that none of its economic and social programmes disrupts local efforts to revive the economy and expand economic activities.
- > Third, work with aid and development partners to boost social overhead capital – roads, bridges, river ports, and communication systems to upgrade and expand connectivity

- throughout the country. Cooperation with development partners for a longer-term effort to re-engage in the provision of public services—such as upgrading infrastructure, expand public services, and create a cadre of professional civil servants who serve the public.
- > Fourth, the Government and development partners can work with and incentivize local communities to expand and upgrade their facilities – schools, health clinics, boreholes and watering points – and improve the quality of public services through a collaborative approach.
- > Fifth, it is essential that the government sustains ongoing public financial management reforms to maintain macroeconomic stability and expand the fiscal space to improve the provision of services for citizens.

Finally, as a short-term measure, government should consider introducing administrative measures for the benefit of resource poor households, such

as targeted distribution of subsidized staple foods, market-based transfers, and other forms of social safety nets. However, such subsidy-based distributions need strong precautionary measures to minimize the inclusion of errors, otherwise, the benefit goes to unintended groups. Also, evidence suggests that the use of cash transfers would be appropriate in such cases as this empowers the household with decision-making. Households understand better the pressures they face (be it health, food, production inputs and so forth) proving that, as noted by international experience, the bulk of cash transfers

are used in socially and economically productive ways.

Expanding the cash transfer programmes is particularly attractive given what this brief has outlined, reflecting that the economy is suffering from deficiency of real demand because real incomes have been depressed. The income boost from cash transfers will increase household expenditure which in turn can revive confidence, stimulate enterprise development, ease family pressures, and promote a broader range of economic activity.

Conclusion

Key conclusions of the policy brief include:

The main trigger of inflation and food price increase:

The collapse of oil prices that led to a reduction of government revenue and subsequent government action of increasing domestic borrowing is a main trigger of the increase of prices (inflation), in particular, food prices. It is important to underscore that the drop in oil prices is not necessarily the main trigger of inflation in-and-of-itself, but government's initial response of expansionary measures of borrowing from the Central Bank, instead of reduction in expenditure, contributed to inflation.

Support measures to reduce the burden of inflation:

The situation of inflation and continued depreciation of the SSP was in dire conditions in 2020. Without the assistance from development partners (food support, development grants, special IMF credit such as the RCF, etc.), the rate of inflation from government borrowing would have been significantly greater than it actually was.

Short term measures versus long term sustained solutions:

Although there is pressure for immediate results to shift the economic situation, there are no quick fixes to reduce prices. It is likely that prices will continue to increase at a decreasing rate, then stabilize, before a reduction is observed. However, major changes in food price reduction can be expected only with an increase in food production/availability, and overall sustained improvement in the macroeconomic environment.

Ensure transparency in the management and use of national and external resources to build trust:

Providing evidence on what resources provided by development partners during the pandemic are used for is important for building trust. The use of the first tranche of the RCF for auction is unclear, but transparency would help to understand who was able to access and obtain the forex at a cheaper rate. An analysis of what resources are used for and who is affected positively and negatively is important. Concerted efforts to improve trust needs to be made by government by demonstrating their commitment to good governance. Without this commitment, and programmes to demonstrate such commitment, development partners could stop providing additional resources in the future as the support will not benefit ordinary South Sudanese for whom the resources are intended. Whatever option(s) government chooses to maintain economic stability, the effects on expectations and confidence (and the rebuilding of trust) should be central.

Finally, to maintain economic stability, government should continue to refrain from actions that have detrimental impact on the economy and continue public financial management reforms. This includes avoiding unnecessary borrowing from the Central Bank, rationalize its existing debt, rebuild reserves, and ensure public security is maintained. Policy recommendations proposed from this brief focus on the need for economic stability in general and the ripple effect this will have on food prices.