

CURRENCY EXCHANGE RATE AND FOOD SECURITY ETHIOPIA

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World Food
Programme

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HIGHLIGHTS

- The Birr has lost 5% of its value on the official market over the last year, and 16% in the parallel market as of March 2024. Due to the increasing divergence of the exchange rates gap between the official and the parallel markets, remittances are increasingly diverting from official to unofficial channels.
- The National Bank of Ethiopia (NBE) intends to achieve an exchange rate that avoids major or protracted disparities in the parallel market and raise the currency reserve from the current 0.7 months to 1 month towards the end of the current fiscal year and to 2 months by June 2025.
- If the Government decides to devalue the Birr in the official market as part of its plan to achieve internal and external currency stability, the costs of imported goods used in production processes (such as fertilizers and fuel) will rise, which consequently pushes the cost of living upwards and poor households will be disproportionately affected.

1. ETHIOPIAN BIRR FALLS TO A NEW ALL-TIME LOW IN THE PARALLEL MARKET AGAINST THE US DOLLAR

While one dollar is exchanged against 56.55 Birr on the official market, the Ethiopian Birr has dropped to a new record low of 116 against the US dollar in the parallel market in mid-March 2024. This suggests that the parallel market premium—which is calculated as the ratio of the parallel market rate to the official rate less one—has increased to a new high. The difference between the official and parallel markets, which was approximately 17% in January 2022 and 74% in January 2021, increased to an astounding 105% in March 2024. Since January 2019, when the NBE implemented creeping devaluation, the Birr's value has fallen by 75% in the official market and 155% in the parallel market. Birr has lost 5% of its value on the official market over the last year, and 16% in the parallel market as of March 2024. The sustained and widening divergence of the exchange rates gap between the official and the parallel markets, remittances are increasingly diverting from official to parallel market channels. Foreign currency is also syphoned via illegal money transfers, an unofficial money transfer route that works outside of the banking system. Ethiopians in the diaspora transmit foreign currency to Ethiopian middlemen, who pay beneficiaries in local currency at the parallel market rate.

Ethiopia relies on diaspora remittances, exports, services, tourism, foreign direct investment, and foreign loan disbursements to acquire foreign currency that is necessary to run the economy healthy. Several economic and political challenges facing the country, including inflation, unrest in various parts of the country, reduced foreign direct investment (FDI), and continued reduction of export earnings, have all contributed to the Birr's ongoing depreciation versus major currency baskets .

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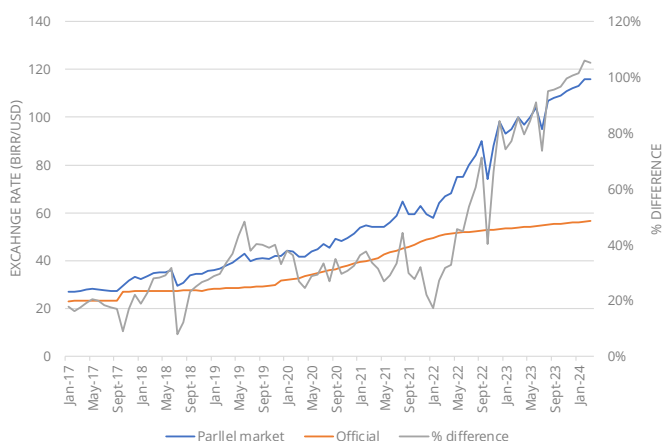
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¹ Ethiopia's foreign currency crisis is not unique; other major African economies, such as Nigeria, Egypt, and Kenya, are experiencing similar problems.

FIGURE 1: TRENDS OF OFFICIAL AND PARALLEL MARKET EXCHANGE RATE (USD AGAINST BIRR)



Source: NBE (official) and WFP (parallel)

GOVERNMENT MEASURES AND POLICIES

The NBE has devalued the Birr on several occasions, most notably in September 2010 (16.7 percent devaluation against the dollar) and November 2017 (15 percent devaluation against the dollar), with the objective of encouraging export. Between the end of 2018 and mid-2021, the government implemented a creeping devaluation of the Birr, with monthly depreciations ranging from 1 to 6 percent. The devaluation measure is criticized by some experts as one major cause fueling inflation directly through raising the price of imports and indirectly by raising the import bill of the government, which is a big spender in the economy. Thus, some experts discourage devaluation till it is preceded by significant export and food production growth². On the other hand, other experts, including the World Bank and IMF, contend that the Ethiopian economy is suffering from overvalued exchange rate and attributed the inflation to factors other than devaluation such as instability and the surge in the prices of commodities in the global market³. There is an ongoing negotiation between IMF and the Ethiopian authorities to borrow about \$3.5 billion and a similar amount from the World Bank⁴. The NBE intends to achieve an exchange rate that avoids major or protracted disparities in the parallel market and raise the currency reserve from the current 0.7 months to 1 month towards the end of the current fiscal year and to 2 months in June 2025⁵. Among others, devaluing birr may be part of the strategy to achieve these targets, and this may have implications on the food security of vulnerable people.

In March 2024, the Ethiopian Investment Board has issued a new directive that will allow foreign investors in export, import, wholesale, and retail commerce sectors. The directive allows foreign investment in exports including coffee, oilseeds,

pulses, and hides and skins. It also allows the import of all items except fertiliser and petroleum. Under the directive, any foreign investor can invest in wholesale and retail commerce in any sector that used to be reserved for local investors. The issuance of this directive may be a step taken by the Ethiopian government to open up the economy to obtain loans from international financial institutions. This measure is considered as a way to ease to secure foreign exchange⁶.

To properly use the limited foreign exchange for imports of essential products such as food, medical, and industrial supplies, the Ministry of Finance has stopped credit lines for 38 items deemed non-essential.⁷

THE IMPLICATION OF THE DEVALUATION/ DEPRECIATION OF BIRR ON FOOD SECURITY

- Several traders also rely on the parallel market to access foreign currency to import goods and services as getting foreign currency from the legal channel is difficult. This is particularly true in Somali region where a significant proportion of food is imported via informal routes making use of forex obtained from the parallel market. Hence, the depreciation of Birr in the parallel market has deleterious effect on the food security situation of the consumers that rely on imported foods for their consumption.
- As the gap between the official and parallel markets exchange rates continues to be significant and sustained, price levels in the economy often reflect the parallel market exchange rate. The continued depreciation of Birr against US dollar in the parallel market pushes up prices of imported goods (including food) and often leads to higher inflation rates while contributing to the erosion in household purchasing power (meaning household can afford less food with the same amount of money).
- If the GoE decides to devalue the Birr at significant rate or switch to floating Birr (decision to let supply and demand in the foreign exchange market determine the currency's value) shortly as part of its strategy to avoid major or protracted disparities between official and parallel markets, the costs of imported goods used in production (such as fertilizers and fuel) will rise, which may contribute to lower domestic food production and, ultimately, making local produce less affordable. As the increased cost passes to the consumers, poor households will be disproportionately affected, and the food security status of more households will be jeopardized.

² https://www.researchgate.net/publication/346649752_The_Challenge_of_Inflation_and_Financing_Development_in_Ethiopia_A_Kaleckian_Approach_with_Empirical_Result

³ <https://documents1.worldbank.org/curated/en/586131512139181555/text/121807-BRI-PUBLIC-EthiopiaImpactsOfTheBirrDevaluationOnInflation.txt>

⁴ <https://www.bloomberg.com/news/articles/2024-01-12/ethiopia-s-currency-quandary-places-imf-deal-on-knife-s-edge>

⁵ https://nbe.gov.et/wp-content/uploads/2024/01/StrategicPlan_PV.pdf

⁶ The prime minister also mentioned that his government is considering to allow foreigners even to purchase residential properties attract more foreign direct investment

⁷ <https://www.fanabc.com/english/ministry-of-finance-bans-38-items-from-entering-the-country/>