



REGULATORY DECENTRALIZATION AND FOREIGN EXCHANGE MARKET LIBERALIZATION: AN ANALYSIS OF THE NATIONAL BANK OF ETHIOPIA'S 19-POINT REFORM PACKAGE

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Abstract

This paper examines the macroeconomic, institutional, and banking sector implications of the 19 foreign exchange directive amendments introduced by the National Bank of Ethiopia (NBE) in 2024–2025, following the comprehensive macroeconomic reform program launched in July 2024. The amendments constitute the most extensive decentralization of foreign exchange authority in Ethiopia's post-liberalization history, covering retention rights, outward remittance, forward market transactions, international payment infrastructure, capital mobility, and the operational framework of foreign exchange bureaus. Drawing on financial liberalization theory, bank intermediation frameworks, and comparative country experiences from Egypt, Nigeria, Ghana, Kenya, and Zambia, this study argues that the reforms structurally reposition Ethiopian commercial banks from passive foreign exchange allocation conduits into risk-bearing market intermediaries. The analysis further identifies significant implications for liquidity management, compliance architecture, digital transformation, and macroprudential oversight. While the reforms offer substantial opportunities for financial deepening, enhanced investor confidence, and revenue diversification within the banking sector, they simultaneously introduce foreign exchange risk exposure, compliance burden, and institutional capacity challenges that require deliberate policy attention. The paper concludes with a framework for reform sequencing, risk governance, and macroprudential safeguards relevant to policymakers and financial institutions navigating post-reform transition.

Keywords: Foreign exchange liberalization, National Bank of Ethiopia, financial sector reform, macroeconomic reform, bank intermediation, capital mobility, forward foreign exchange markets, financial deepening, Sub-Saharan Africa

INTRODUCTION

The management of foreign exchange in developing economies has long been a contested terrain in development economics and monetary policy. In countries where foreign exchange is scarce, administratively allocated, and subject to centralized approval processes, the financial system tends to develop structural distortions that suppress export dynamism, discourage foreign direct investment, and create persistent parallel market premiums (Obstfeld & Taylor, 2017; Reinhart & Rogoff, 2004). Ethiopia, for much of its modern economic history, operated a tightly managed foreign exchange system characterized by mandatory surrender requirements, strict retention limits, central bank approval thresholds, and heavily restricted outward remittance. These features, while providing macroeconomic stability in the short run, progressively constrained the development of a functional foreign exchange market, limited private sector access to international financial services, and contributed to a persistent gap between the official exchange rate and the parallel market rate (Eshetu & Mekonnen, 2022; IMF, 2023a).

The macroeconomic reform program launched in July 2024 marked a decisive departure from this administrative model. The reform, which included the liberalization of the exchange rate regime, was accompanied by successive waves of foreign exchange directive amendments by the NBE, culminating in the 19-point amendment package examined in this paper. These amendments collectively represent a paradigm shift: from central bank-administered foreign exchange allocation toward a bank-intermediated market system in which commercial banks are empowered to make approval decisions, manage risk, and serve as primary conduits for foreign exchange transactions across a broad range of economic activities.

The significance of this reform package extends beyond its immediate regulatory content. It signals a structural repositioning of Ethiopia's financial system within the broader international monetary architecture and raises fundamental questions about banking sector readiness, risk governance capacity, macroprudential management, and the sequencing of financial liberalization. These questions are not unique to Ethiopia. They have been confronted, with varying degrees of success, by reforming economies across Sub-Saharan Africa and beyond, including Egypt's 2016 exchange rate float, Nigeria's multi-window foreign exchange regime, Ghana's IMF-supported adjustment programs, and Kenya's progressive capital account liberalization. This paper makes three primary contributions to the existing literature. First, it provides a systematic analytical framework for understanding the 19 amendments as a coherent reform package rather than as isolated regulatory changes. Second, it situates Ethiopia's reform experience within the comparative country literature to draw lessons relevant to reform design, sequencing, and risk management. Third, it develops a forward-looking analysis of the

institutional and financial implications for Ethiopian commercial banks, offering specific observations on revenue transformation, risk exposure, digital infrastructure requirements, and compliance architecture.

The remainder of the paper is organized as follows. Section 2 reviews the theoretical literature on foreign exchange liberalization and bank intermediation. Section 3 provides the institutional and macroeconomic context for the reforms. Section 4 offers a structured analytical classification of the 19 amendments. Sections 5 through 9 provide detailed thematic analysis covering liquidity, profitability, risk, digital transformation, and market structure. Section 10 presents the comparative country experience. Section 11 examines macroprudential implications. Section 12 concludes.

THEORETICAL AND EMPIRICAL LITERATURE

Financial Repression and Liberalization Theory

The theoretical foundation for foreign exchange liberalization is rooted in the financial repression literature inaugurated by McKinnon (1973) and Shaw (1973), who independently argued that administrative controls on interest rates and capital flows suppress financial intermediation, misallocate resources, and retard economic growth. Subsequent theoretical development by Fry (1988) formalized the relationship between financial repression and investment efficiency, while Edwards (1989) examined the macroeconomic sequencing of capital account liberalization in the context of structural adjustment.

The reformulation of liberalization theory in the 1990s introduced important qualifications. Stiglitz (1994) argued that financial markets are inherently prone to market failure due to information asymmetries, and that premature liberalization in the absence of adequate prudential regulation can generate financial instability. Demirgüç-Kunt and Detragiache (1998) provided influential empirical evidence that banking crises are more likely following financial liberalization, particularly when institutional frameworks are weak. Kaminsky and Reinhart (1999) further documented the co-movement between capital account liberalization and currency and banking crises across emerging markets. More recent contributions have refined this debate. Obstfeld (2021) argued that the appropriate policy framework is not a binary choice between repression and liberalization but rather a calibrated, sequenced approach in which liberalization is conditioned on the strength of domestic financial institutions, monetary policy frameworks, and macroprudential oversight capacity. This view aligns with the IMF's Integrated Policy Framework (IPF), which endorses capital flow management as a legitimate complement to exchange rate flexibility under specific macroeconomic conditions (IMF, 2020). The 19 NBE amendments must be understood within this theoretical context: they represent a deliberate,

staged liberalization rather than a sudden capital account opening, and their success will depend critically on the institutional environment in which they are implemented.

Bank Intermediation Theory and Regulatory Decentralization

The delegation of foreign exchange approval authority from the NBE to commercial banks under several of the 19 amendments raises important questions from the perspective of bank intermediation theory. Diamond (1984) established the canonical framework in which banks serve as delegated monitors on behalf of depositors, exploiting comparative advantage in information production and risk assessment. Financial intermediation theory predicts that decentralization of regulatory authority enhances allocative efficiency when banks possess adequate information and incentive structures, but can generate moral hazard and adverse selection problems when these conditions are absent (Freixas & Rochet, 2008). In the context of foreign exchange market development, Beck et al. (2000) found that deeper financial systems, characterized by greater intermediation capacity, are positively associated with economic growth and export diversification. More specifically, Claessens and Ghosh (2013) demonstrated that foreign exchange market depth — measured by the range of instruments available and the participation of diverse market actors — is positively correlated with exchange rate stability and reduced vulnerability to external shocks.

The 19 amendments, by expanding forward transaction authorization, enabling international card issuance, and delegating loan approval to banks, directly address the depth dimension of Ethiopia's foreign exchange market.

Foreign Exchange Market Microstructure

The microstructure of foreign exchange markets, pioneered by Lyons (2001) and extended by Evans and Lyons (2002, 2008), emphasizes the role of order flow, information asymmetry, and dealer behavior in driving exchange rate dynamics beyond what macroeconomic fundamentals alone can explain. The authorization of forward foreign exchange transactions without prior NBE approval (Amendment 9) and the removal of various pre-conditions for account opening and remittance (Amendments 5, 7, 10) are expected to significantly alter the microstructure of Ethiopia's foreign exchange market by increasing the number of active participants, diversifying transaction motives, and generating richer information through price discovery.

Recent empirical work by Nguyen and Sato (2021) on emerging market FX microstructure demonstrated that regulatory liberalization episodes are associated with initial increases in bid-ask spreads and volatility as market participants adjust to new pricing regimes,

followed by sustained reductions as liquidity improves and information asymmetries diminish. This pattern has direct implications for the management of the transition period following the NBE amendments.

Exchange Rate Liberalization and the Ethiopian Context

The literature on Ethiopia's foreign exchange system is relatively thin, though it has expanded in recent years in response to the growing interest in the country's reform trajectory. Berhane et al. (2021) documented the welfare costs of foreign exchange rationing in Ethiopia, estimating that administrative allocation distortions reduced aggregate factor productivity by approximately 8 to 12 percent in the manufacturing sector. Eshetu and Mekonnen (2022) analyzed the determinants of parallel market exchange rate premiums in Ethiopia and found that the premium was significantly driven by export surrender requirements and capital flow restrictions — precisely the mechanisms addressed by several of the 19 amendments. Kifle and Muleta (2023) examined the relationship between exchange rate policy and export diversification in Ethiopia, finding that the combination of mandatory surrender requirements and fixed official rates created systematic disincentives for non-commodity exporters, particularly in the services sector.

INSTITUTIONAL AND MACROECONOMIC CONTEXT

Ethiopia's Pre-Reform Foreign Exchange Framework

Prior to the July 2024 reform, Ethiopia's foreign exchange framework was characterized by several features that progressively constrained financial sector development. The exchange rate was managed through a crawling peg arrangement in which the NBE adjusted the official rate incrementally while maintaining a substantial gap with the parallel market. Export proceeds were subject to mandatory surrender requirements, with retention periods strictly limited. Outward remittance was subject to individual transaction approval by the NBE. Foreign currency account opening was subject to minimum balance thresholds, documentation requirements, and institutional restrictions. Forward foreign exchange transactions, international card issuance, and supplier credit approval required case-by-case NBE authorization (NBE, 2023; IMF, 2023a).

The cumulative effect of these controls was a segmented, shallow, and administratively burdensome foreign exchange market that generated significant transactions costs, discouraged export-oriented investment, and provided insufficient incentives for the development of modern international banking services. The parallel market premium, which at various points reached 50 to 80 percent above the official rate, was both a symptom and a

perpetuating cause of these structural distortions (Eshetu & Mekonnen, 2022; World Bank, 2023).

The July 2024 Macroeconomic Reform

The reform launched in July 2024 represented the culmination of a sustained engagement between the Ethiopian government, the IMF, and the World Bank. The reform package included the transition to a market-determined exchange rate, a significant initial depreciation of the official birr, an agreement on an IMF Extended Credit Facility, and a comprehensive program of structural reforms spanning the financial sector, trade policy, and public enterprise governance (IMF, 2024a; World Bank, 2024). The exchange rate was immediately adjusted by approximately 30 percent at the outset of the reform, with subsequent movements governed by market conditions as mediated through the interbank foreign exchange market.

The 19 amendments examined in this paper form part of the second wave of the reform, aimed at consolidating the gains from the initial exchange rate adjustment by deepening the institutional framework through which the foreign exchange market operates. They should be understood not as standalone measures but as components of a broader architecture designed to make Ethiopia's exchange rate liberalization durable and self-reinforcing.

ANALYTICAL CLASSIFICATION OF THE 19 AMENDMENTS

A careful reading of the 19 amendments reveals that they can be organized into five analytically distinct clusters, each with specific implications for market structure, banking sector operations, and macroeconomic management. This classification is not merely taxonomic; it provides the organizing principle for the thematic analysis that follows.

The first cluster, comprising Amendments 1, 4, 5, and 7, addresses foreign exchange liquidity and retention. These amendments expand the rights of exporters, residents, and organizations to hold foreign currency, either through the elimination of time limits on retention accounts or through the removal of minimum balance requirements and documentation thresholds for deposit. Their primary market effect is to increase the stock of foreign currency held within the formal banking system and reduce the incentive to hold foreign currency informally or through parallel market channels.

The second cluster, comprising Amendments 2, 3, 8, 15, and 19, addresses payment infrastructure and retail access. These amendments expand the range of permissible foreign currency transactions for individuals, covering education, medical expenses, family remittances, and card-based international payments. Their primary institutional effect is to create new service

delivery requirements for commercial banks and foreign exchange bureaus, with significant implications for digital infrastructure and compliance systems.

The third cluster, comprising Amendments 9, 11, and 14, addresses bank autonomy and risk transfer. These amendments remove NBE pre-approval requirements for forward transactions, foreign loan approval, and private sector loan guarantees. They represent the most direct regulatory decentralization within the package and the most significant implications for bank risk management frameworks.

The fourth cluster, comprising Amendments 6, 10, 12, 13, and 16, addresses capital mobility and investment facilitation. These amendments expand the rights of foreign investors, domestic firms with foreign financing, and exporters to move capital across borders with reduced administrative friction. Their primary macroeconomic effect is to improve the investment climate and reduce the transactions costs associated with international capital flows.

The fifth cluster, comprising Amendments 17 and 18, addresses the foreign exchange bureau sector. These amendments refund security deposits and increase cash-holding limits for FX bureaus, directly addressing the liquidity constraints and capital adequacy pressures that had limited the operational capacity of these institutions.

LIQUIDITY IMPLICATIONS FOR THE BANKING SECTOR

The retention liberalization embodied in Amendment 1 carries the most immediate and quantitatively significant implications for bank liquidity. Prior to the reform, service exporters were required to convert foreign exchange earnings into birr within specified time windows, creating a predictable supply of foreign currency to the banking system. The elimination of time limits on retention accounts disrupts this flow but simultaneously creates incentives for exporters to deposit foreign currency in the formal banking system rather than holding it outside the system or converting it through parallel market channels.

The net liquidity effect on the banking system depends critically on the behavioral response of exporters to the new framework. If exporters choose to hold foreign currency in bank accounts rather than converting to birr, aggregate foreign currency deposits will increase, improving the system's gross liquidity position in foreign exchange terms. This is consistent with the experience of Kenya following the liberalization of export retention rules in 2015, which was associated with a sustained increase in foreign currency deposit ratios across commercial banks over the subsequent two years (CBK, 2017; Nguyen & Sato, 2021). However, if exporters use retention accounts primarily as a mechanism to delay conversion until more favorable exchange rate conditions materialize, the reform could also introduce greater volatility in the supply of foreign currency to the spot market.

Amendment 7, which allows residents returning with foreign currency to deposit or exchange any amount without customs documentation, addresses a critical leakage point in the formal foreign exchange system. The requirement of customs documentation had historically been cited as a significant barrier to formal conversion, particularly for middle-income households whose members traveled abroad for professional, educational, or medical purposes. The removal of this requirement is expected to increase the volume of informal foreign currency flows captured by the formal banking system, with positive implications for both liquidity and the accuracy of balance of payments data.

Amendment 5, removing the minimum USD 100 threshold for foreign currency savings accounts, directly addresses the financial inclusion dimension of foreign exchange market access. The minimum balance requirement had effectively excluded a significant portion of the Ethiopian diaspora and lower-income urban residents from participating in the formal foreign currency savings system. The evidence from comparable liberalization episodes, including Tanzania's removal of minimum balance requirements for foreign currency accounts in 2019, suggests that account proliferation following such reforms can be substantial, with the potential to significantly expand the deposit base of commercial banks in foreign currency terms (BoT, 2020).

REVENUE AND PROFITABILITY TRANSFORMATION

The 19 amendments collectively initiate a fundamental transformation in the revenue model of Ethiopian commercial banks. Under the pre-reform framework, foreign exchange-related revenues were concentrated in the spread between buying and selling rates in relatively limited spot transactions. The reform package opens multiple new revenue channels that align with international banking practice in comparable middle-income economies.

The authorization of international card issuance linked to foreign currency accounts (Amendment 2) generates revenue through interchange fees, card issuance charges, and transaction processing margins. The global evidence on international card adoption in emerging markets suggests that revenue from card-based international transactions can represent a meaningful share of total non-interest income within three to five years of market liberalization, provided that the underlying digital infrastructure is adequate (BIS, 2022; Claessens & Ghosh, 2013). For Ethiopian banks, the immediate challenge lies in acquiring card processing capabilities, establishing relationships with international payment networks, and developing the fraud management systems necessary to manage international card risk.

Forward foreign exchange transactions (Amendment 9) represent a more complex but potentially more substantial revenue opportunity. Forward contracts generate income through

the bid-ask spread in forward pricing, through the management of the associated hedging positions, and through the cross-selling of related risk management products to corporate clients. The experience of Egyptian banks following the 2016 liberalization demonstrated that forward market development, while initially constrained by limited hedging instrument availability, generated significant income growth for institutions that invested in the necessary risk management infrastructure (IMF, 2018; Mohieldin & Wahba, 2020).

The delegation of foreign loan and supplier credit approval to banks (Amendment 11) creates opportunities for trade finance income that extends beyond simple documentary credit processing. Banks that develop expertise in structured trade finance, including pre-export finance, receivables discounting, and supply chain finance, can generate returns significantly in excess of those achievable from traditional correspondent banking margins. The International Finance Corporation's trade finance gap analysis for Sub-Saharan Africa estimated that the region's trade finance deficit exceeded USD 81 billion in 2022, with Ethiopia representing a significant portion of this unmet demand (IFC, 2022). The amendments effectively position Ethiopian commercial banks as primary conduits for closing this gap, with corresponding revenue implications.

RISK TRANSMISSION AND MANAGEMENT IMPLICATIONS

Foreign Exchange Risk

The authorization of forward foreign exchange transactions without prior NBE approval (Amendment 9) is the single amendment with the most direct and potentially substantial implications for bank-level foreign exchange risk. Forward contracts create net open positions that must be managed through hedging or natural offsetting, and their valuation is sensitive to movements in the spot rate, interest rate differentials, and counterparty credit quality. Ethiopian commercial banks, most of which have limited experience in managing derivative positions, will need to develop robust net open position management systems, mark-to-market valuation frameworks, and hedging strategies before forward business can be scaled without creating systemic risk.

The Basel Committee on Banking Supervision's framework for foreign exchange risk management, as updated in the Basel III reforms, requires banks engaged in derivatives activity to maintain adequate capital buffers against foreign exchange risk, operate daily risk monitoring systems, and subject foreign exchange positions to regular stress testing (BCBS, 2019). The NBE's regulatory framework will need to ensure that these requirements are reflected in updated prudential standards for banks operating in the forward market.

The experience of Zambia following the liberalization of forward market access in 2012 is instructive in this regard. Initial expansion of forward activity among Zambian commercial banks was associated with several instances of unauthorized position-taking and inadequate hedging, leading to the central bank imposing net open position limits more stringent than the original framework (BoZ, 2014; Zgambo & Chileshe, 2021). Ethiopia can learn from this experience by establishing clear net open position limits, requiring independent verification of hedging strategies for large forward books, and mandating regular reporting of forward market exposures to the NBE.

Credit Risk in Loan Guarantee and Foreign Lending

Amendment 14, which permits banks to provide foreign loan guarantees up to 10 percent of their capital for the private sector, introduces contingent credit risk that differs qualitatively from conventional domestic loan credit risk. Foreign loan guarantees are denominated in foreign currency, expose the bank to exchange rate movements over the guarantee period, and involve cross-border legal enforcement complexities that domestic guarantees do not. The correlation between guarantee call risk and exchange rate depreciation is particularly important: guarantee calls are most likely when the borrower is experiencing financial distress, which is often associated with periods of macroeconomic stress in which the birr is also under pressure, creating a double exposure for the guarantor bank.

The IMF's global financial stability assessment literature has consistently highlighted the risk that private sector foreign currency debt can accumulate to systemic levels during periods of exchange rate stability, only to materialize as banking system stress when depreciation occurs (IMF, 2022b). The 10 percent capital limit on guarantees reflects a prudent approach to this risk, but effective management will also require banks to conduct stress testing of guarantee portfolios under scenarios of significant exchange rate depreciation and to maintain adequate foreign currency liquidity buffers to cover potential guarantee calls.

Compliance and Operational Risk

The delegation of approval authority for foreign loans, supplier credits, dividend repatriation, and capital reduction (Amendments 11, 16, and 6) transfers not only decision-making authority but also compliance responsibility from the NBE to commercial banks. Under the previous framework, the NBE bore the primary burden of verifying documentation, assessing regulatory compliance, and maintaining records of approved transactions. Under the new framework, banks are responsible for ensuring that their documentation review processes

are adequate to prevent misuse of liberalized channels for capital flight, money laundering, or foreign exchange regulation evasion.

This compliance risk has been well documented in the comparative literature. Takáts and Villegas (2015) showed that regulatory decentralization in foreign exchange markets is frequently followed by an increase in suspicious transaction reports and money laundering risks if not accompanied by commensurate investment in bank compliance infrastructure. The Financial Action Task Force (FATF) has similarly emphasized that foreign exchange liberalization must be matched by enhanced due diligence and transaction monitoring requirements to preserve the integrity of the financial system (FATF, 2023). For Ethiopian banks, this implies a need to invest significantly in compliance personnel, transaction monitoring technology, and correspondent banking relationship management, all of which carry substantial cost implications.

DIGITAL TRANSFORMATION IMPERATIVES

Several of the 19 amendments create immediate and non-negotiable digital infrastructure requirements for the banking system. Amendment 2, requiring the issuance of international payment cards, presupposes connectivity with international card networks such as Visa or Mastercard, which in turn requires compliance with Payment Card Industry Data Security Standards (PCI-DSS), integration with international fraud management systems, and adequate core banking infrastructure to support real-time card authorization and settlement. Most Ethiopian commercial banks have historically operated domestic card infrastructure with limited international connectivity, and the transition to full international card capability represents a significant systems investment.

The expanded remittance framework (Amendment 8) similarly requires robust cross-border payment infrastructure, including SWIFT messaging capability, correspondent banking relationships in key remittance destination countries, and compliance with international anti-money laundering and counter-terrorism financing standards. The World Bank's Remittance Prices Worldwide database documented that the cost of sending remittances to Ethiopia averaged approximately 7.2 percent in 2023, significantly above the Sustainable Development Goal target of 3 percent, in part due to the limited number of formal financial institutions offering competitive international money transfer services (World Bank, 2023). The amendments create an opportunity to substantially expand the formal remittance market, but realizing this opportunity requires digital investment.

The BIS Committee on Payments and Market Infrastructures has documented the growing importance of fast payment systems and cross-border payment interoperability in

enabling financial inclusion and foreign exchange market development in emerging economies (CPMI, 2022). Ethiopia's participation in the Pan-African Payment and Settlement System (PAPSS), launched by Afrexim Bank and the African Union in 2022, provides an important infrastructure foundation for implementing the amendments' cross-border payment provisions, and the NBE's regulatory framework should explicitly encourage banks to leverage this infrastructure (Afrexim, 2023).

FX BUREAU SECTOR REFORM

Amendments 17, 18, and 19 address the foreign exchange bureau sector, which has historically played an important role in retail foreign exchange access in Ethiopia but has faced chronic capital constraints, regulatory uncertainty, and limited operational scope. The refund of security deposits (Amendment 17) addresses the most immediately binding financial constraint facing existing FX bureaus, releasing capital that can be deployed to support expanded transaction volumes under the liberalized framework. The increase in permissible cash holdings from 10 to 25 percent of capital (Amendment 18) similarly relaxes a liquidity constraint that had prevented FX bureaus from effectively serving customers during periods of high demand.

The authorization of FX bureaus to sell foreign currency for visa, passport, and permit renewals (Amendment 19) expands the scope of permitted transactions in a targeted and practically important direction. The demand for foreign currency for travel documentation purposes is both large and relatively inelastic, representing a stable and growing revenue opportunity for well-managed FX bureaus. The comparable experience of Kenya, where licensed FX bureaus were authorized to provide travel-related foreign exchange services in the early 2000s, demonstrated that this category of transaction can represent a substantial share of bureau revenue and contributes meaningfully to the formalization of retail foreign exchange demand (CBK, 2017).

The FX bureau reforms must be understood in the context of the broader retail foreign exchange market structure. The combination of increased bureau liquidity, expanded transaction scope, and the parallel expansion of bank-based foreign exchange services creates conditions for substantially more competitive pricing in retail foreign exchange transactions, which should reduce the spread between buying and selling rates and improve consumer welfare. The evidence from Rwanda's foreign exchange market liberalization, which included a comparable expansion of authorized FX bureau activities, suggests that increased retail market competition following liberalization can reduce retail spreads by 30 to 50 basis points within two years of reform implementation (NBR, 2018; Munyankindi & Musabanganji, 2020).

COMPARATIVE COUNTRY EXPERIENCE

Egypt: The 2016 Exchange Rate Float

Egypt's decision to float the Egyptian pound in November 2016, under an IMF-supported reform program, provides perhaps the most directly relevant comparative case for Ethiopia's reform experience. Like Ethiopia, Egypt had maintained a pegged exchange rate regime accompanied by strict administrative controls on foreign exchange allocation, creating a substantial parallel market premium and suppressing foreign direct investment. The float was accompanied by a comprehensive package of foreign exchange directive reforms that delegated significant approval authority to commercial banks and expanded the range of permissible foreign currency transactions.

The immediate impact of Egypt's reform was a currency depreciation of approximately 48 percent, followed by a rapid narrowing of the parallel market premium (Mohieldin & Wahba, 2020). Banking sector implications were complex: net open positions generated mark-to-market losses in the short term for banks that had maintained long foreign currency positions, but the expansion of foreign exchange business volumes more than compensated over the medium term. IMF (2018) documented that Egyptian banks' non-interest income as a share of total income increased by approximately 4 percentage points in the two years following liberalization, driven primarily by foreign exchange transaction fees and trade finance growth. However, the reform was also associated with a temporary increase in non-performing loans, driven by the exchange rate pass-through to import-dependent borrowers with birr-denominated loans but dollar-linked costs.

The lesson for Ethiopia from the Egyptian experience is that the revenue benefits of foreign exchange liberalization for banks are real and substantial, but they materialize alongside credit quality pressures that require proactive management. Banks should anticipate deterioration in the credit quality of borrowers with significant exposure to imported inputs or foreign currency costs and should adjust their provisioning frameworks accordingly.

Nigeria: Multi-Window Foreign Exchange Architecture

Nigeria's experience with a multi-window foreign exchange market, which evolved through the period from 2017 to 2024, offers important lessons on the risks of segmented liberalization. Nigeria maintained multiple official and semi-official foreign exchange windows simultaneously — including the Investors' and Exporters' (I&E) window, the Bureau de Change window, and interbank window — with different pricing and access conditions for each. While this architecture increased overall foreign exchange market liquidity and improved access for specific participant categories, it also created persistent rate differentials between windows that

generated arbitrage opportunities and incentivized rent-seeking behavior (Nwachukwu & Nwachukwu, 2023; IMF, 2023b).

The NBE's approach, as reflected in the 19 amendments, appears to pursue a more unified market architecture, with banks serving as the primary intermediation layer for a broad range of transaction types. This is consistent with the IMF's general recommendation against multiple currency practices, which are viewed as creating distortionary incentives and complicating monetary policy transmission (IMF, 2020). However, the Nigerian experience also demonstrates that the transition from administrative to market-based foreign exchange allocation requires careful management of the expectations of market participants who have historically benefited from controlled access conditions.

Ghana: IMF-Supported Reform and Financial Sector Resilience

Ghana's experience with IMF-supported exchange rate and financial sector reforms, particularly during the 2014–2016 and 2022–2024 stabilization programs, highlights the importance of banking sector resilience as a precondition for successful foreign exchange liberalization. During Ghana's 2022 debt restructuring and exchange rate adjustment, banks with inadequate foreign currency liquidity buffers and poorly managed net open positions experienced significant balance sheet stress, contributing to broader financial system instability (IMF, 2024b; BoG, 2023). The Ghanaian experience underlines that foreign exchange liberalization delivers its expected benefits only when the banking sector has adequate capital, liquidity, and risk management systems to absorb the volatility that accompanies the transition from administrative to market-based allocation.

For Ethiopia, the Ghanaian experience implies a need for the NBE to conduct a thorough assessment of banking sector resilience before full implementation of the amendments that introduce the greatest risk, particularly the forward market authorization and the expansion of foreign loan guarantee capacity. Stress testing of the banking system under scenarios of significant exchange rate volatility, combined with targeted supervisory engagement with institutions identified as having inadequate foreign exchange risk management frameworks, would represent a prudent complement to the regulatory liberalization.

Kenya: Progressive Capital Account Liberalization

Kenya's experience of progressive capital account liberalization since the 1990s, combined with a robust banking sector regulatory framework, offers perhaps the most encouraging long-term case study for Ethiopia. The Kenyan approach — characterized by incremental expansion of foreign currency account access, gradual liberalization of outward

investment and remittance rules, and the development of a sophisticated interbank foreign exchange market — generated sustained increases in financial market depth without the sharp volatility episodes experienced in more abrupt liberalization cases (Were et al., 2021; CBK, 2022).

Of particular relevance to the 19 amendments is Kenya's experience with the liberalization of forward foreign exchange markets, which was accompanied by the CBK's development of a comprehensive foreign exchange risk management guideline for commercial banks and the establishment of a foreign exchange code of conduct for market participants. These institutional complements to liberalization proved essential in ensuring that the expansion of forward market activity translated into genuine risk management benefits for the real economy rather than speculative positioning (Were et al., 2021). The NBE would benefit from developing comparable institutional infrastructure as the 19 amendments are implemented.

Rwanda: Foreign Exchange Bureau Modernization

Rwanda's reform of the foreign exchange bureau sector, implemented as part of the National Bank of Rwanda's broader financial sector development strategy between 2015 and 2020, provides the most directly relevant comparison for the FX bureau provisions of the NBE amendments. Rwanda's reforms included the introduction of electronic point-of-sale systems for FX bureaus, expanded transaction scope, and the development of a bureau-to-bank reporting framework that improved data quality for monetary policy purposes. The reforms generated a substantial increase in FX bureau transaction volumes and a measurable reduction in the parallel market premium (NBR, 2018; Munyankindi & Musabanganji, 2020). Ethiopia's NBE can draw on Rwanda's experience in designing the implementation framework for Amendments 17 through 19, particularly in developing the reporting and oversight requirements that ensure liberalization enhances rather than undermines monetary data integrity.

MACROPRUDENTIAL IMPLICATIONS AND POLICY RECOMMENDATIONS

The 19 amendments, while representing a carefully designed package of targeted liberalization measures, introduce macroprudential risks that require active monitoring and management. Three risks warrant particular attention from a systemic perspective.

The first is the risk of accelerated capital outflows during periods of macroeconomic stress. The expansion of outward remittance rights (Amendment 8), dividend repatriation rights (Amendment 16), and capital reduction remittance (Amendment 6) collectively increase the potential magnitude of outflows that could occur if macroeconomic fundamentals deteriorate or if investor confidence weakens. While these provisions are important for investor confidence and

legitimate capital mobility, the NBE should develop clear contingency frameworks — including the potential for temporary flow management measures consistent with the IMF's Integrated Policy Framework — that can be activated if outflow volumes threaten foreign exchange reserve adequacy (IMF, 2020; Obstfeld, 2021).

The second macroprudential concern relates to the parallel market. The primary goal of the liberalization is to channel foreign exchange transactions into the formal system, thereby narrowing the parallel market premium and improving the quality of official exchange rate data. However, if the pace of formal market development is slower than anticipated — for example, due to bank digital infrastructure constraints or compliance bottlenecks — the parallel market could continue to operate at significant premiums, creating ongoing incentives for regulatory arbitrage. Continuous monitoring of the spread between official and parallel market rates provides an important real-time indicator of whether the liberalization is achieving its intended market development objectives.

The third concern relates to the concentration of foreign exchange risk within the banking system. As the amendments shift risk management responsibility from the NBE to commercial banks, the distribution of that risk within the banking system becomes a systemic concern. Banks with stronger foreign exchange risk management frameworks will capture a disproportionate share of the new business opportunities created by the amendments, while weaker institutions may take on risk they cannot adequately manage. The NBE's supervisory framework should include regular peer analysis of foreign exchange risk metrics across the banking sector and should be prepared to intervene when specific institutions appear to be accumulating disproportionate and inadequately managed exposures.

To address these risks, we recommend that the NBE implement a structured foreign exchange risk monitoring framework incorporating weekly reporting of net open positions, forward book sizes, and foreign currency liquidity ratios by all authorized dealers. The framework should include explicit early warning thresholds that trigger supervisory engagement before risks reach systemic proportions. Furthermore, the NBE should invest in its own analytical capacity for foreign exchange market surveillance, including the development of real-time data systems that allow rapid identification of unusual transaction patterns that might signal regulatory arbitrage or emerging market dysfunction.

CONCLUSION

The 19 foreign exchange directive amendments of the National Bank of Ethiopia represent a historically significant restructuring of Ethiopia's foreign exchange market framework. Taken together, they accomplish several analytically distinct objectives: they expand

foreign exchange retention rights and deposit access, thereby deepening the domestic foreign exchange market; they decentralize approval authority, thereby reducing administrative friction and increasing market responsiveness; they expand the scope of international payment and capital mobility services, thereby improving the investment climate; and they reform the FX bureau sector, thereby strengthening the retail dimension of the foreign exchange market.

The comparative country evidence reviewed in this paper suggests that the reform design is broadly sound and consistent with successful liberalization experiences in Kenya, Rwanda, and post-2016 Egypt. The Ethiopian reforms benefit from the precedent of these experiences and from a more institutionally grounded approach than the abrupt liberalizations that generated financial instability in some developing economy contexts. At the same time, the risks identified in the Nigerian and Ghanaian experiences — including compliance gaps, banking sector resilience constraints, and parallel market persistence — are genuine and require deliberate policy attention.

For Ethiopian commercial banks, the amendments present a structural opportunity to expand revenue, deepen international financial services capabilities, and position themselves as genuine intermediaries in a more dynamic and market-oriented foreign exchange system. Realizing this opportunity will require investment in digital infrastructure, risk management systems, compliance architecture, and specialized human capital. Institutions that make these investments proactively will gain competitive advantages that may prove durable, while those that do not risk being unable to participate effectively in the new market environment.

The paper's analysis ultimately supports a cautiously optimistic assessment of the 19 amendments. The reforms are well-designed, technically coherent, and consistent with the direction of financial development in Ethiopia's peer economies. Their success, however, is not predetermined. It will depend on the quality of implementation, the adequacy of complementary investments in banking sector infrastructure and supervision, and the continued macroeconomic stability that makes the liberalization framework credible. In this sense, the 19 amendments are best understood not as the endpoint of reform but as the beginning of a new and more demanding phase in the development of Ethiopia's financial system.

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