

Is realignment of exchange rates a right policy for the Bank of South Sudan?

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Many African countries, faced with currency crisis implement various exchange rate systems, often featuring secondary or unofficial currency markets that function alongside an exchange rate set through interbank transactions or auctions. Discrepancies arise between these markets, requiring thorough examination of the dynamic impacts of various policy tools.

Over the last couple of weeks, the Central Bank's indicative exchange rate has been depreciating at unprecedented speed. As a result, the parallel market exchange rate has also continued its year long depreciation spree. This has left many people to question as to why the Central Bank's reference exchange rate has been trending toward black market rate after it has been stable at the par of 158,000 SSP per 100 USD between March and July 2024 as shown in the graph below.

Therefore, the aim of this article is to explain what the Bank of South Sudan (BoSS) has been doing, since March 2024 and why it must continue to move toward that direction. Indeed, the BoSS is trying to realign the parallel and official exchange rates in order to bring the premium between both exchange rates to the conventional level of 2 percent. Per the BoSS's strategic plan (2023-2027), it hopes to ensure that the gap between its benchmark and parallel exchange rates do not **exceed 2 percent** by the end of the current strategic plan in 2027.

The realignment of exchange rates refers to the process of adjusting the value of a country's currency to reflect its true economic situation. This adjustment is often necessary when there are significant disparities between a currency's market value and its perceived value, often due to factors like inflation, changes in interest rates, or government interventions.

Since the country gained independence in 2011, the exchange rate was pegged to the dollar at par of 2.999 SSP per the dollar. While the parallel exchange rate was at 3.951 SSP per dollar, as September 2011. Indeed, the gap between these rates was very tight until the second quarter of 2017 when the gap between them got widens at a historic pace. In fact, the gap between the two rates started to widen at a very rapid pace after the country switched to managed float exchange rates in 2015. Then exchange rates were realigned by October 2021 which remained in force until the gap widened again in March 2024.

Therefore, realignment of exchange rates is the right policy considering the fact that high premium between these two rates often encourages arbitrage activities and resource misallocation. For instance, if there is a huge gap between the two FX markets, then arbitrageurs would do everything possible to access foreign currencies at the official exchange rate and sell the proceeds at the black-

market exchange rate which may lead to volatility and speculation in the FX market. Consequentially, if more people, especially those who are connected to powerful political elites, engage in this activity, speculative activities often emerged in the currency market and damaged public confidence in the local currency leading to a vicious circle where resources are plowed back into unproductive sectors with serious consequences on productivity and the real economy exacerbating the output gap. Just like any other central bank in the world, the main mandate of the Bank of South Sudan is to main low and stable inflation in order to preserve the purchasing power of the SSP.

Therefore, the BoSS often endeavors to realign exchange rates so that market participants have a level playing field. In the other words, the monetary authority is trying to eliminate rent-seeking behaviors associated with multiple exchange rates. That being said, the goal is for all economic actors to have access of buying foreign exchange they need to meet their transactional demands from authorized dealers at fairly equal exchange rate.

Due to the limited policy options, the Central Bank through reserve money requirements employed a framework for its interventions in the exchange market aimed at reducing the gap progressively. Thus, the Bank had previously adopted foreign exchange auctions as a main intervention instrument. The purpose is to allow the interbank market to further develop and thus achieve a better price setting according to the law of supply and demand, as banks should refer to Bank of South Sudan as a last resort.

From fiscal authority perspective, undervalued exchange rate deprives the government of revenues since the Ministry of Finance and Planning doesn't get the market exchange rate of its oil receipt that it sold to the Central Bank using official exchange rate which is often way below market determined exchange rate. That say, unification of exchange rates would boost government revenues so it could meet its budgetary obligations.

However, the key question that a common man may ask is how long should we continue with realignment of the exchange rate. Essentially, realignment of exchange rate will continue until the government addresses structural weakness in the balance of payment.

This can be address through adoption of sound structural, fiscal, and monetary policies. For instance, structural economic policies can be used to remove structural rigidities in the system. Furthermore, the Central Bank and the Finance Ministry should implement right mixed of both monetary and fiscal policies.

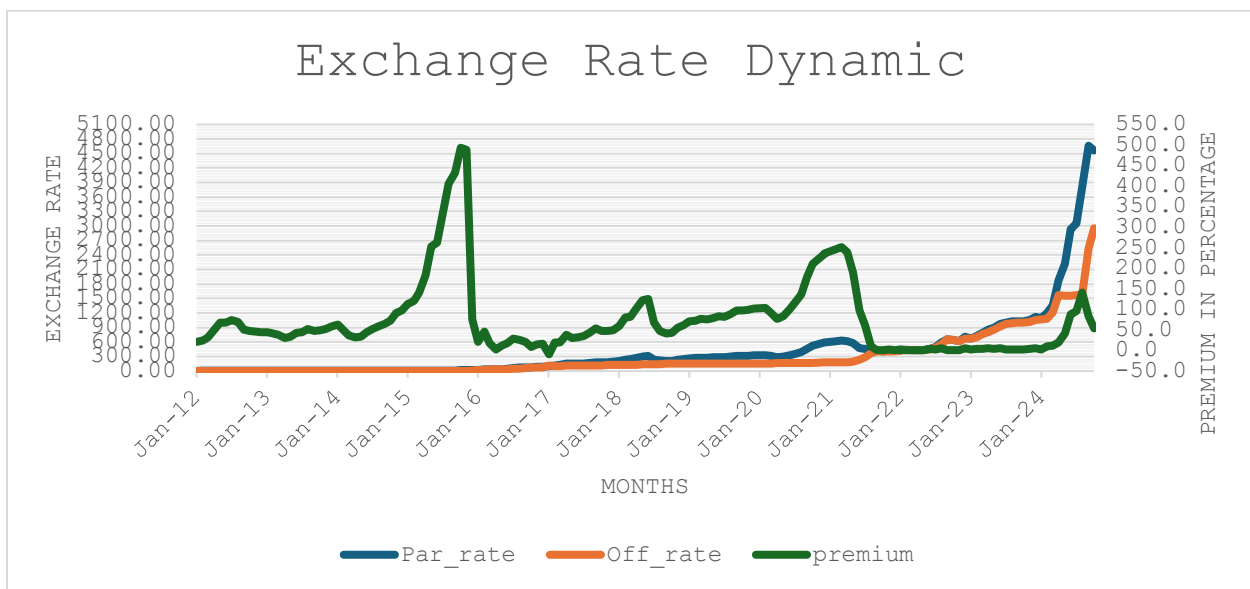
Furthermore, the country can address exchange rate crisis by producing more goods and services and be able to export to neighboring countries and earned foreign exchange as a result. As a matter of fact, export promotion strategy can help the country plugs balance of payment deficit and reduce pressure on the South Sudan pound. South Sudan has about more than 94 percent of arable land unutilized due logistical and infrastructure challenges.

But to address these challenges, the government ought to train human capital and provide them with capital that will help them to produce more goods and services in more efficient and innovative way. For example, the government should provide technical education to farmers across

the country and then provide them tools such as tractors and affordable credit facilities for them to do large scale farming. By so doing, farmers will produce enough food beyond subsistence. Hence, they will transact the surplus in the marketplace and provide to those who didn't produce enough food for themselves creating economic incentive

More generally, there is a need to diversify the economy in order to make it shock resistant. In other words, the country ought to move away from being dependent on the oil industry to other sectors of the economy.

Lastly, long-lasting stability in the foreign exchange market will come only when we achieve low and stable inflation for a minimum period of five years. However, this entails that the Central Bank and the Finance Ministry must pursue right mixed of monetary and fiscal policies in order to maintain macroeconomic stability.



Source; Bank of South Sudan, statistical bulletin, 2024, author compilation, 2024.

Although both official and parallel exchange rates were so tight in nominal term at the par of 2.95SSP/1USD and 3.38SSP/1USD, respectively, as of January, 2012; the black market premium was at 21 percent. As the graph indicated, official and parallel exchange rates moved closely between January 2012 and November 2015. However, the premium has continued to trend upward to its peak of 493.4 percent by October 2015. It's because of this huge premium why economists and policymakers saw it appropriate to devalue the SSP against the greenback in October 2015. But shortly after the exchange rate was devalued, the premium came down to **2.9 percent as of April 2016**. Furthermore, there was another spike in February 2021 as the premium **reached 251.7%**. As a matter of fact, the successful exchange rate realignment was achieved between

August 2021 and october 2023 as the premium was maintained within **2 percent target**. However, the premium has continued to widen since october 2023.

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