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September 21, 1984

To: Members of the Executive Board
From: The Secretary
Subject: Somalia - Exchange Arrangements

Attached for the information of the Executive Directors is a paper on a change in the exchange arrangements of Somalia.

Att: (1)

Other Distribution:
Department Heads



INTERNATIONAL MONETARY FUND

Somalia--Exchange Arrangements

Prepared by the African Department and the Exchange and
Trade Relations Department

(In consultation with the Legal Department)

Approved by J.B. Zulu and W.A. Beveridge

September 20, 1984

In the attached communication dated September 14, 1984 the Central Bank of Somalia has informed the Fund that with effect from September 15, 1984 the middle rate of the Somali shilling has been changed to So.Sh. 26.0000 = US\$1 from So.Sh. 17.5556 = US\$1, representing a 32.5 percent devaluation vis-à-vis the U.S. dollar. On July 1, 1983 Somalia adopted an exchange arrangement whereby the Somali shilling was to be pegged to the SDR adjusted for relative price movements in Somalia vis-à-vis the five countries included in the SDR basket; ^{1/} the exchange rate was to be maintained within margins of ± 7.5 percent around the fixed real SDR relationship. In accordance with this arrangement, the Somali shilling was depreciated by a cumulative 13.1 percent relative to the U.S. dollar, the intervention currency, during the four-month period to end-October 1983. Since then, no further adjustments in the exchange rate for the Somali shilling had been effected, until the September 15 action.

With domestic prices increasing at a rapid pace, the value of the Somali shilling appreciated sharply in real effective terms after October 1983. At the time the 1983 Article IV consultation with Somalia was discussed by the Executive Board in April 1984, the real effective appreciation of Somalia's exchange rate since the introduction of the new exchange arrangement in July 1983 had amounted to 52 percent, according to the standard index developed in connection with the information system on real effective exchange rates; on the basis of the same index, the value of the Somali shilling was estimated to have appreciated a further 25 percent in real effective terms during the period April-July 1984. In terms of the real SDR basket adopted by the authorities in establishing Somalia's exchange arrangement in July 1983, the appreciation of the shilling after taking into account the recent devaluation amounts to approximately 35 percent.

Economic conditions in Somalia deteriorated sharply during 1984. With the virtual depletion of official foreign exchange reserves and a large fiscal gap, the domestic inflation rate is projected to reach

^{1/} Somalia--Exchange Arrangements (EBD/83/184, 7/8/83).

150 percent in 1984. Reflecting the scarcity of foreign exchange, the value of the shilling in the unofficial parallel exchange market had fallen to less than one fourth of the value in the official market before the recent exchange rate adjustment. In addition, Somalia is having difficulties servicing its debt obligations, and as at the end of August 1984 had accumulated arrears to the Fund amounting to SDR 5.5 million.

The recent exchange rate action represents, in the staff's opinion, a welcome step by the authorities regarding their exchange rate policy. The authorities fully recognize that this change should be viewed in the context of the real effective appreciation of the Somali shilling noted above, and of the difficult economic conditions that have emerged since the end of 1983. Accordingly, in the attached communication the authorities indicate their intention to continue to adjust the exchange rate gradually until it is within the margins stipulated by their exchange arrangement.

While agreement had been reached on the launching of a structural adjustment program with the Fund in early 1984, the authorities subsequently decided to postpone the enactment of new reforms, particularly on the external sector, in the wake of difficulties arising from a ban by Saudi Arabia on cattle imports from Somalia and from the potential impact of unfavorable weather conditions on foreign exchange receipts. In a staff visit during September 8-13, 1984, the authorities indicated their intention to undertake adjustment measures and viewed the above devaluation as an initial step. It is the view of the staff that the weakening of Somalia's economic performance in 1984 has increased the urgency for the design and implementation of a set of comprehensive and consistent measures needed to re-establish domestic and external financial stability.

Attachment

INTERFUND
WASHINGTON, DC

SEPTEMBER 14, 1984

EFFECTIVE SEPTEMBER 15, 1984, THE EXCHANGE RATE OF THE SOMALI SHILLING VIS-A-VIS THE U.S. DOLLAR HAS BEEN CHANGED FROM SO. SH. 17.5556 TO SO. SH. 26.00 PER U.S. DOLLAR. THE GOVERNMENT WILL CONTINUE TO ADJUST THE RATE GRADUALLY UNTIL IT IS WITHIN THE MARGINS STIPULATED BY OUR EXCHANGE SYSTEM.

DR. OMAR AHMED OMAR
GOVERNOR
CENTRAL BANK
SOMALBANCA MOGADISHU

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