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SOMALIA - 2024 - ASSESSMENT LETTER FOR THE CENTRAL BANK OF SOMALIA

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International Monetary Fund
Washington, D.C.

Somalia—Assessment Letter for the Central Bank of Somalia

December 16, 2024

This letter provides IMF staff's assessment of macroeconomic policies in Somalia. It also discusses the authorities' intention to reintroduce the Somali Shilling and implement a currency board arrangement, which the IMF will be supporting through extensive capacity development and the Extended Credit Facility arrangement. This assessment letter has been requested by the Central Bank of Somalia with the objective of sharing it with international partners to explain the currency reform and seek their support.

Economic Outlook and Risks

1. **Somalia's real GDP growth outlook has improved, though risks remain significant.** Positive trends in agriculture, exports, and remittances in 2024 are expected to continue in 2025. As a result, real GDP growth has been upgraded to 4 percent in 2024 and 2025. Inflation is expected to continue on a downward trend to 4.5 percent by end 2024, although the pace is slower than anticipated earlier. Despite security challenges, the Somali government remains steadfast in its fight against terrorism and continues to work with international partners to ensure a successful transition from the current African Union Transition Mission to a new force by January 2025. Risks to the outlook include climate shocks, domestic and regional security developments, lower global growth, and higher commodity prices.

2. **Somalia has maintained a strong track record of reform implementation.** Notwithstanding significant domestic and regional challenges, the authorities remain committed to all program objectives, and see the engagement with the Fund and other international partners as key to building a stronger economy and more resilient institutions. Performance under the ongoing three-year Extended Credit Facility (ECF) arrangement has been satisfactory, with significant progress on structural reforms.

Policy Priorities and Structural Reforms

3. **The 2025 budget advances the authorities' program objectives, though continued access to grant financing remains critical.** An overall fiscal deficit of 1.2 percent of GDP is expected in the 2025 budget, which accommodates higher spending on education and health while moving towards the objective of fully covering operational expenditure with domestic revenues by 2027.[1] Until the latter objective is met, Somalia would be best served with continued access to budget support grants. Access to grant financing also remains critical to support development expenditure.

4. **Steady progress is needed on fiscal reforms.** Continued progress on domestic revenue mobilization is needed, including on customs modernization, implementation of the Income Tax Law, stronger enforcement of sales and income taxes, and enhancement of revenue administration. The authorities should continue to strengthen their capacity on public financial management, public investment management, and debt management. They should also ensure completion and implementation of the legal framework in the petroleum sector, including the necessary regulations to enhance transparency and good governance.

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[1] For program purposes, operational expenditure includes non-project compensation of employees, goods and services, and interest payments.

5. The authorities are advancing important institutional reforms to promote financial deepening and financial inclusion. Priorities include enhancing the legislative and oversight frameworks, improving the quality of regulatory data, and augmenting technical capacity of the Central Bank of Somalia (CBS). Efforts should continue to strengthen the framework for anti-money laundering and the combating the financing of terrorism to comply with international standards.

6. The Somali authorities intend to reintroduce the Somalia Shilling (SOS). The currency exchange project will reintroduce the SOS as legal tender by replacing old and mostly counterfeit notes in circulation. The reform aims to restore the credibility of the national currency, promote financial inclusion for the most vulnerable populations that have limited access to formal financial services, and fulfill an important liquidity function by facilitating payments for small value transactions. The authorities are taking steps to secure a firm agreement between the Federal Government of Somalia (FGS) and all Federal Member States (FMS) on the currency exchange project and address operational issues with technical support from the World Bank. Estimates from 2022, which will need to be updated, suggest the total cost of the currency exchange project is about US$75 million, for which the authorities need support from international partners.

7. Along with the currency exchange, the authorities are starting preparations for introducing a currency board arrangement (CBA) with support of IMF capacity development (CD) and the ECF arrangement. A CBA will provide a stable and predictable policy environment to ensure confidence in the national currency across Somalia, while maintaining a dual currency regime with the U.S. dollar. Starting in December 2024, IMF CD support is helping with the design and implementation of the CBA by providing guidance on the operational and institutional aspects, building staff capacity for managing and operating within a CBA framework, and advising on the necessary changes to the legal and regulatory framework. To support the successful design and implementation of the CBA, key measures have been included as structural benchmarks under the ECF arrangement—for instance, under the program, the authorities have committed to submitting amendments to the CBS Act to Parliament by end-December 2025, and additional measures can be considered for inclusion in upcoming reviews. The currency exchange project and the CBA are expected to be implemented in 18-24 months once the pre-requisites are in place. This will include securing the funding and a firm agreement between the FGS and all FMS for the currency exchange, and ensuring that the CBS has enough gross international reserves to back the new SOS on the central bank balance sheet (estimated at about US$40-60 million, which corresponds to the estimated range of old shillings currently in circulation at the prevailing exchange rate).

8. To protect the credibility of the currency board arrangement, complementary policies should be in place. In addition to ensuring that the CBS maintains foreign reserves that fully cover its monetary liabilities after the CBA is introduced, complementary actions include measures to (1) ensure fiscal and debt sustainability; (2) ensure CBS operational independence and prevent deficit financing of the government; (3) strengthen CBS capacity, including the cash management function, and policies to promote transparency; (4) secure financial stability, develop financial markets, and support capacity building of financial institutions; and (5) improve the quality, frequency, and timeliness of macroeconomic and financial data. IMF CD and the ECF arrangement also support the implementation of these complementary policies, for instance through conditionality on fiscal deficits and net international reserves, and CD on improving the quality and timelines of macroeconomic and financial statistics.

9. Sustained efforts are crucial to increase resilience, reduce poverty, and promote inclusive growth, with the support of international partners. Greater human capital is needed to boost growth, including by improving access to education. Building resilience against climate shocks and strengthening food security is also a priority. Given Somalia's very limited resources, financing and technical assistance support from international partners remains crucial.

10. Staff assesses Somalia to be at moderate external and overall risk of public debt distress, and debt is assessed to be sustainable in the medium-term. The authorities continue good faith negotiations to finalize debt relief agreements with remaining creditors that have any HIPC eligible debt. Total public debt is projected to increase to US$778 million in 2024 from US$766 million in 2023 but decline in terms of GDP from 7 percent of GDP in 2023 to 6.4 percent of GDP in 2024. Most public debt is external. The authorities recognize the importance of relying on concessional financing post-HIPC to contain debt sustainability risks. They also agree on the need to strengthen debt management capacity. The authorities expect that ongoing reforms, in particular domestic revenue mobilization, will improve the country's debt servicing capacity.

Relations with the Fund

11. IMF financial support: Somalia successfully completed a three-year ECF program in December 2023 (with access level of SDR 252.86 million, approved in March 2020), notwithstanding multiple shocks and challenges, including the Covid-19 pandemic, prolonged and severe drought, desert locust infestation, and significant security risks. On December 13, 2023, Somalia reached the HIPC Completion Point, unlocking US$4.5 billion in debt relief. On December 19, 2023, the IMF Executive Board approved a new three-year arrangement under the ECF with access of SDR 75 million (approximately 45.9 percent of quota). The 2nd review of the ECF program was completed on December 9, 2024.

12. Surveillance and CD. The most recent Article IV consultation was concluded on December 9, 2024, jointly with the 2nd ECF program review. Extensive IMF CD to Somalia is supported by the Somalia Country Fund. CD activities are integrated with Somalia's ECF arrangement and complement the activities of other technical assistance providers.

Table 1. Somalia: Selected Economic and Financial Indicators, 2022–29

	2022	2023	2024		2025		2026	2027	2028	2029
		Est.	Prog.	Proj.	Prog.	Proj.		Proj.		
National income and prices										
Nominal GDP in millions of U.S. dollars	10,203	10,969	12,804	12,111	13,891	13,018	14,197	15,584	16,973	18,205
Real GDP in millions of U.S. dollars	10,203	10,633	11,108	11,058	11,541	11,501	11,972	12,463	12,999	13,584
Real GDP, annual percentage change	2.7	4.2	3.7	4.0	3.9	4.0	4.1	4.1	4.3	4.5
Real GDP per capita in U.S. dollars	653	662	673	670	680	678	687	697	710	723
CPI (period average, percent change)	6.8	6.2	4.8	5.3	3.9	4.2	3.6	3.4	3.2	3.0
CPI (e.o.p., percent change)	6.1	6.6	4.3	4.5	3.7	3.9	3.5	3.3	3.1	2.6
					(Percent of GDP)					
Central government finances 1/										
Revenue and grants	7.1	6.8	7.1	7.5	5.9	6.8	5.1	4.6	4.6	4.7
of which:										
Revenues	2.6	3.0	2.8	3.0	2.1	3.3	3.6	3.9	4.2	4.5
Grants 2/	4.5	3.8	4.3	4.6	2.8	3.5	1.5	0.8	0.5	0.3
Expenditure (FGS)	7.1	6.7	7.5	7.7	7.2	8.0	7.1	6.9	6.9	7.1
Compensation of employees	2.5	2.7	2.8	3.0	2.7	2.9	2.8	2.7	2.6	2.6
Purchase of non-financial assets	0.1	0.2	0.3	0.3	0.3	0.3	0.4	0.4	0.6	1.0
Overall balance	0.0	0.1	-0.5	-0.2	-1.3	-1.2	-2.0	-2.3	-2.3	-2.4
Net change in the stock of cash	0.4	0.3	-0.4	-0.1	-0.3	-0.6	0.0	0.0	0.0	0.0
Public debt 3/, 4/	38.2	7.0	6.1	6.4	6.6	6.6	8.1	9.6	11.1	12.7
					(Percent of GDP)					
Monetary Sector										
Net Foreign Assets	-1.4	1.6	1.5	1.6	1.5	1.6	1.6	1.6	1.6	1.5
Central Bank claims on non-residents 5/	3.1	3.3	2.8	3.0	2.6	2.8	2.5	2.3	2.0	1.8
Net Dometic Assets	15.5	14.3	12.7	14.2	12.0	14.1	13.9	13.0	12.2	11.7
Credit to the private sector	3.9	4.9	4.8	5.1	5.0	5.3	5.6	5.8	6.1	6.4
Broad Money 6/	14.2	15.9	14.2	15.8	13.5	15.7	15.5	14.5	13.8	13.2
Gross International Reserves (program definition, in millions of US$)	265.5	265.3	265.3	265.3	265.3	265.3	263.4	259.6	251.1	230.7
in months of next year's imports 7/	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.2
					(Percent of GDP)					
Balance of payments										
Current account balance	-8.6	-9.3	-8.7	-8.9	-8.8	-8.7	-9.8	-10.0	-10.0	-10.0
Trade balance	-62.9	-60.8	-58.2	-61.4	-57.2	-61.1	-58.5	-57.8	-57.6	-57.4
Exports of goods and services	17.7	19.7	18.9	20.5	20.1	21.1	21.8	22.5	22.8	23.1
Imports of goods and services	80.6	80.6	77.1	81.8	77.2	82.2	80.3	80.3	80.5	80.4
Remittances	21.0	19.2	18.8	19.8	18.9	19.9	20.1	20.1	20.1	20.1
Grants	33.7	32.7	31.0	32.9	29.8	32.8	29.0	28.1	27.8	27.6
Foreign Direct Investment	5.2	5.2	5.4	5.7	5.4	5.4	5.4	5.4	5.4	5.4
External debt 3/	37.5	6.4	5.6	5.9	6.1	6.1	7.6	9.2	10.8	12.4

Sources: Somali authorities; and IMF Staff estimates and projections.
1/ Budget data for the Federal Government of Somalia. Fiscal operations are recorded on a cash basis. GDP data cover the entire territory of Somalia.
2/ A change in World Bank policy for countries with moderate risk of debt distress that replaces the previous 50:50 mix of grants and loans with 100 percent loans (with 50-year maturity), will impact Somalia starting in July 2025. Lower grants would result in deficits of 1.5 to 2.0 percent of GDP, higher than the ones projected under the alternative before this policy change. The difference with previous deficit projections would dissipate over time as the previous deficit projections already incorporated a gradual shift away from grants to loans.
3/ Includes HIPC debt relief, including HIPC interim assistance received between the Decision and Completion Points, and MDRI and beyond-HIPC debt relief at Completion Point in 2023.
4/ Public debt includes arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt. Consistent with the public debt definition in the DSA. It includes net SDR position of the FGS.
5/ Includes FGS grants held abroad.
6/ Primarily desposits at commercial banks.
7/ For Somalia's de facto dollarized economy, reserve to imports coverage is less applicable.