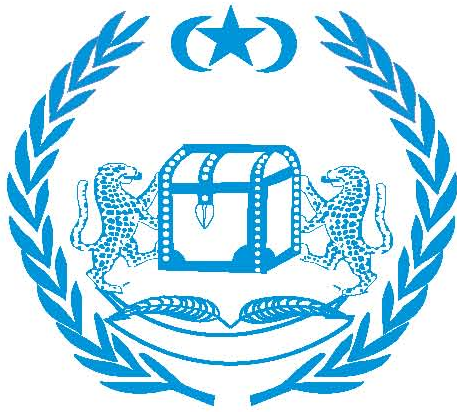




CENTRAL BANK OF
SOMALIA

ANNUAL REPORT 2012



CENTRAL BANK OF
SOMALIA

Annual Report 2012



The compilation of this report was sometimes a difficult exercise because of the lack of available information to use for analysis. Somalia's periods of conflict interrupted the Central Bank's ability to gather and report information relevant to this report. However, despite the absence of information (e.g., more economic data) that would enhance this annual report, great strides were made in completing it. Nevertheless, what follows bears testimony to the fact that relevant and supporting information may be missing in some sections.

Central Bank of Somalia Annual Report, 2012

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1. FOREWORD

Starting in September 2012, Somalia entered into a new post-transitional government era, and with this new beginning, it embarked on the crucial mission of rebuilding its failed institutions, with the support and encouragement of the world community. Cognizant of this, H.E. President Hassan Sheikh Mohamud launched a six-pillar program as his government's top priority to guide recovery and reconstruction of Somalia. The two most important of these pillars are Public Financial Management Reform and Economic Recovery as critical issues to be tackled by his administration. An effective and functioning Central Bank of Somalia (CBS) is key to achieving both of these goals.

In addition to these political gains, 2012 was marked by relatively fragile economic recovery with relative growth and some improvement in macroeconomic positions triggered by improvement in the general business climate. However, foreign reserves positions were not yet in place as the Central Bank was not fully operational and therefore not in a position to help contain fluctuation and volatility in the purchasing power of the Somali Shilling.

Developments in the banking sector continued to be unfavorable, reflecting the lack of a fully-functioning supervisory regime. There was little improvement in the quality of financial services and little growth in lending to the private sector, except the limited services offered by money transfer companies (known in Somalia as "hawalas"). However, the diminished financial services industry in Somalia creates space for the banking sector to play an important role in improving the general economy.

The Central Bank Act No. 130 of April 2011 was approved by the Parliament. Though it clearly defines the roles and responsibilities of the Central Bank, it was not implemented. This led to inconsistent policies made by the Central Bank. More money transfer companies entered into the market, some with unclear and opaque purposes. Access to credit was not established but a few commercial banks were given temporary licenses and began paving the way for full licensing and operations. However, the Central Bank was not prepared and it did not have the capacity to provide required services or supervise established banks.

On a positive note, commercial enterprises managed to develop and introduce innovative approaches to expand the private sector. Some of them organized and mobilized much-needed resources to expand their operations. The Somali Diaspora, both from individual households and businesses, contributed many of these resources for productive investments, which mainly focused on construction, trades, and telecommunications. This influx of investment money contributed to the expansion of the private sector and promoted some job creation and related activities. However, the economy's significant potential has not been realized – this

would require complementary actions by the Central Bank, the promotion of other financial institutions as well as development partners to support Somalia in its path to recovery and development. Entrepreneurial activities that emphasize value-added production are transforming the economy and should be strongly promoted and facilitated by the Central Bank of Somalia and commercial banks. Therefore, it is urgent to work with all key stakeholders to establish critical financial institutions to drive further productive investment.

On the regional front, the Central Bank of Somalia remained isolated and without a working relationship with other central banks in the region in the implementation of various regional banking initiatives. In this regard, the Central Bank has taken all the necessary steps to implement the Central Bank Act of 2011 and the Financial Institutions Act of 2012. Furthermore, the Central Bank has taken initiatives to promote collaboration with central banks in Eastern and Southern Africa. These interactions are expected to gear toward strengthening regional integration to promote policy harmonization and to ensure, among other objectives, the enhancement of a functional and effective local and regional payments system within Somalia and among neighboring countries.

The Central Bank will continue to cement its ties with International Financial Institutions (IFIs) such as the International Monetary Fund (IMF), the World Bank (WB) and the African Development Bank Group.

I am pleased to recognize efforts made by the Bank's senior management and staff for their prescience, continued support and commitment to sustaining the initiated pace of economic recovery, growth and development. I also appreciate the support of the government in the formation of a strong, independent Central Bank within the comprehensive framework of Public Financial Management under the leadership of the Ministry of Finance. This annual report is the first report in twenty-two years prepared and published by the Central Bank. As such, it should be considered the basis for future annual reports.



Dr. Abdusalam Omer,
Governor

2. GOVERNANCE AND ORGANIZATIONAL STRUCTURE

The governing body of the Central Bank of Somalia, as stipulated by the Central Bank Act of 2011 in Part IV Section 10, is the Board of Directors. The Board is charged with formulating and supervising implementation of the Central Bank's policies. It also supervises the administration and operations of the Bank. The Board of Directors¹ consists of five directors who are appointed by the President upon the proposal of the Council of Ministers. The governor,² who runs the day-to-day activities of the Bank, is the Chairperson of the Board. The governor, in the capacity of the highest executive officer of the Bank, administers and represents the Bank and ensures enforcement of the provisions of the Central Bank Act of 2011.

The Bank is in the process of establishing a few operational committees to facilitate and improve transparency in all Bank operations. These include but are not limited to: Monetary Policy, Audit, and Executive committees.

Monetary Policy Committee: This committee will determine monetary policy principles and strategies in order to achieve price stability. It is also charged with determining the inflation target along with the federal government within the monetary policy strategy it sets. The committee will be chaired by the governor, composed of Board members recommended by the governor, and others to be selected from academic and business communities.

Audit Committee: This committee will be responsible for auditing all operations and accounts of the Bank. This committee does not have any administrative authority; instead, it is to submit its findings to the Board of Directors through the governor's office.

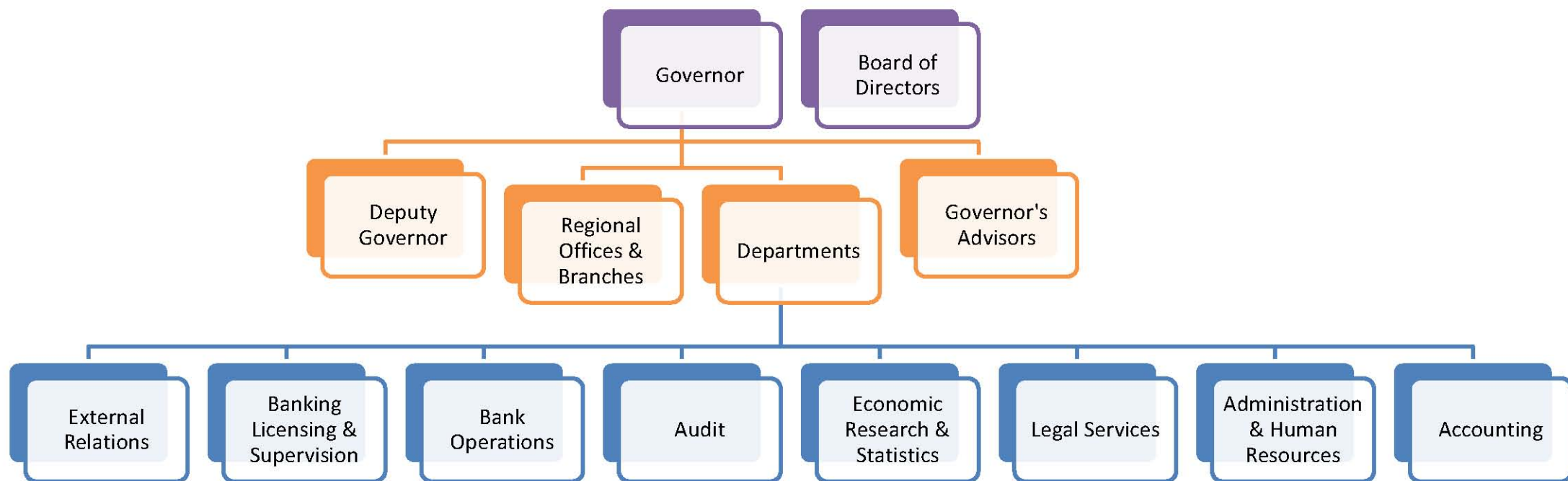
Executive Committee: The primary duties of this committee will be to compile regulations on the administration and organization of the Bank and its services and ensure the Bank's operational coordination. The committee will be composed of the deputy governor under the chairmanship of the governor and a few members of the Board of Directors. It may make recommendations to the governor to open regional offices or branches in the country or propose to send representatives to foreign countries where the Central Bank has a stake or business interest.

The Central Bank is organized into departments and regional offices and branches. In addition, the Central Bank relies on advisors to cover specific issues of interest or undertake studies or research commissioned by the Bank (see Figure 1 below).

¹ The Board of Directors and the deputy governor have not yet been appointed.

² Governor Abdusalam Omer was appointed in February 2013.

FIGURE 1: ORGANIZATIONAL STRUCTURE OF THE CENTRAL BANK OF SOMALIA



3. WORLD ECONOMIC OUTLOOK

Global economic growth remained constrained by economic uncertainty in the Euro area, caused in part by bank deleveraging in some European countries, and fragile financial markets across the world. These factors, combined with globally high unemployment rates, fiscal austerity responses in Europe, and bank exposure to sovereign, particularly European, debt present a challenging outlook for the global economy. According to the World Economic Situation of the UN, the world economy grew by 2.7 percent in 2011 compared with 4 percent in 2010. In 2012, global recovery remained weak, achieving only a 2.2 percent output growth. There are some indications of slow recovery expected in 2013 (see Table 1).

Table 1: Growth of World Output

Country/Region	2010	2011	2012	2013
World	4.0	2.7	2.2	2.4
Developed Economies	2.6	1.4	1.1	1.1
USA	2.4	1.8	2.1	1.1
Japan	4.5	-0.7	1.5	0.6
European Union	2.1	1.5	-0.3	0.6
Developing Economies	7.7	5.7	4.7	5.1
Africa	4.7	1.1	5.0	4.8
East and South Asia	9.0	6.8	5.5	6.0
Latin America and Caribbean	6.0	4.3	3.1	3.9

Source: UN 2013 World Economic Situation and Prospects

As shown in Table 1, developing economies experienced stronger recoveries than developed economies. Growth in developing economies is expected to accelerate from 4.5 percent in 2012 to 5.1 percent in 2013. While developed economies are expected to remain at 1.1 percent, a repeat of 2012's rate of growth. A number of factors are attributed to this slowdown. Europe continued to suffer from its sovereign debt crisis, which, in part, led to reduced economic confidence. Additionally, bank deleveraging and fiscal consolidation remained issues of concern.

Various indicators, including GDP rates, show that Africa is experiencing relatively strong economic growth, even when regions with developed economies are struggling. The region's output rose by 5 percent in 2012 and is projected to slightly decline to 4.8 percent for 2013. This is due to unsustainable commodity prices and weaknesses in developed economies that help cause adverse impact on some African economies.

INFLATION

Inflation receded in a majority of developing economies in 2012, though others faced persistently high rates of inflation. According to the UN World Economic Situation, inflation is expected to slowly decrease across the globe.

In Africa, some countries saw their inflation levels moderate while others, like Angola and Nigeria, experienced high inflation rates above 10 percent. The numbers were even starker for some South Asian countries, some of which had inflation rates above 11 percent, though most of the continent's inflation rates remained stable. For some of these countries, the inflation rate next year will likely hover around 2012 levels, or worse, increase. Japan's central bank, despite its willful efforts to increase national inflation, instead recorded deflation. Across the world, in Latin America and the Caribbean, next year's inflation rates are expected to remain around the 6 percent mark.

Though precise numbers do not exist, by contrast, Somalia's rate of inflation receded. 2012 opened the door for improved economic conditions in Somalia, especially in agriculture and livestock exports, and these conditions are expected to effect a downward shift in inflation levels.

REMITTANCES

It has been estimated by the World Bank that remittances to developing countries continued to rise in 2012 (see Table 2 below). Remittances were estimated to have increased by 12 percent between 2010 and 2011 from US \$332 billion to US \$372 billion. Remittance flows proved to be resilient during the global financial crisis and had even become important as a source of external financing in many developing countries, including Somalia.

Remittance flows were higher in 2011 than in 2010 for all regions, with East Asia and the Pacific accounting for the largest share (29 percent or US\$ 107 billion) followed by South Asia at 26 percent, Latin America and Caribbean at 17 percent, Middle East and North Africa accounting for 11 percent and Sub-Saharan Africa with 6 percent. Within Sub-Saharan Africa, Somalia's share was estimated to be around 9.1 percent.

Remittances to Somalia are the largest source of foreign currency. The Central Bank of Somalia estimates³ that over 60 percent of foreign exchange earnings in Somalia are generated by remittances. Remittances support the largest segment of the country's urban population and fuel an estimated 75 percent of startup business capital. Since security conditions improved in Mogadishu in 2012 and most of the country, remittances and some Diaspora investment money have been used to revitalize the housing sector, which has had a positive economic impact on hundreds of thousands of families and the development of the private sector in a country where foreign assistance has fallen short and foreign direct investment has been virtually non-existent.

Table 2: Remittance Flows to Developing Countries 2009-2011 (US\$ billions)

Regions	2009	2010	2011
Developing Countries	308	332	372
East Asia and Pacific	86	95	107
Europe and Central Asia	36	37	41
Latin America and Caribbean	57	57	62
Middle East and North Africa	34	40	42
South Asia	75	82	97
Sub-Saharan Africa	20	21	22
Somalia⁴	1.5	1.8	2.0

Source: World Bank

SOMALIA'S ECONOMIC OUTLOOK

Somalia's GDP growth is expected to range between seven to ten percent per annum (GDP real growth) during the medium term.⁵ This is to be driven by a number of factors, including significant investment interest from Diaspora Somalis, who are returning in large numbers. Other international investors from countries such as Turkey and Kenya are expected to follow them as a result of the country's increased stability. Expected increase in foreign aid and confidence in the new government, acquired through its rebuilding of public institutions and its creation of a strong accountability framework, will also contribute to an improving economy. Continued rising growth in agriculture and livestock, booming construction and improved

³ Source: CBS estimates.

⁴ Sources: UNDP, WB and CBS estimates.

⁵ Source: Ministry of Finance 2013 Budget Framework.

telecommunications is anticipated to contribute to the overall growth of Somalia's economy.

4. DOMESTIC ECONOMY – OVERVIEW

In the absence of current sector estimates, economic structure can only be inferred from the estimated shares of the population engaged in broad categories of economic activity. However, given the lack of recent household survey and other data sources and how economic indicators are generated, conclusions about GDP shares and related estimates are very speculative.

Despite the absence of an effective national government, Somalia managed to maintain a healthy informal economy, largely based on livestock trade, money transfers, and telecommunications. Livestock is the most important sector of the economy and it contributes 40 percent to the GDP and more than 50 percent of export earnings. Livestock, hides, fish, charcoal and some fruits are Somalia's main exports, while cereals, sugar, khat, and machine goods are the principal imports.

Somalia's small industrial sector, based on the processing of agricultural products, has largely been looted and the machinery sold as scrap metal. The service sector has been growing rapidly in recent years. The hospitality industry continues to operate and is supported by private security. Telecommunications companies provide wireless services across the country and offer the lowest international call rates on the continent. In the absence of formal commercial banking services, money transfer companies have sprouted throughout the country, handling over US\$2 billion in remittances and considerably more in commercial trade. Recently, they have funded various investments. Mogadishu and other liberated areas of Somalia have seen economic expansion following the departure of the terrorist group Al-Shabaab since August 2011. Mogadishu has witnessed the development of shopping centers, supermarkets and flights between Europe (Istanbul-Mogadishu), Middle East (Dubai-Mogadishu), East Africa (Nairobi-Mogadishu) and many more destinations since the collapse of central government in 1991.

Estimates⁶ show that the economy grew (real GDP growth) by 2.6 percent in 2010 and 2.8 – 3 percent in 2011 and 2012. Real output was estimated to amount to US\$ 5.9 billion in 2010 and 6.1 billion in 2011, 6.3 billion in 2012, an increase of 3 percent from US\$5.9 billion. Of the estimated total volume produced, agriculture and livestock contributed 59 percent, while wholesale and retail trade and services contributed 34 percent and manufacturing 7 percent.

⁶ Sources: U.N., World Bank, and CBS estimates.

MACROECONOMIC DEVELOPMENTS

During the 1970s and 1980s, Somalia experienced stagnant per capita output, accompanied by the deterioration of physical infrastructure, a decline in the quality of public services, and severe macroeconomic imbalances. Inflation remained high throughout the 1980s as a result of a rapid increase in credit expansion by the state-run commercial bank, generally to un-creditworthy public enterprises and individuals favored by the ruling regime, as well as the bank's money creation and financing of domestic budget deficits. The eventual collapse of the commercial bank, and the loss of depositors' money, led to a lack of public trust in the banking sector. The tax system was generally cumbersome and tax administration was weak. The revenue to GDP ratio, estimated at 5-8%, remained among the lowest in Africa. High inflation led to a decline in public sector salaries, poor morale, corruption and absenteeism. In brief, there was almost nothing to emulate in the macroeconomic policies followed by the military regime in power. After the collapse of the central government and all public institutions, including the Central Bank, in the early 1990s, the situation further deteriorated and the economy moved from a formal economy to an informal one lead by violence and controlled by warlords and their militias.

However, since 2010, when security started to improve, several sectors of the economy began to take off. These include trade, livestock, telecommunications and agriculture. Spectacular progress has been made in infrastructure with the opening of sea and air ports, which link Somalia to major world markets.

RECENT ECONOMIC DEVELOPMENTS⁷

Only rough comparisons with prewar statistics are possible because of the lack of national income account estimates for the past two decades and more. The rough estimates made by the WB/UNDP indicate that per capita income in the 2000s was about US\$ 226, which is a slight reduction in real terms from 1990. Despite the lack of government throughout much of Somalia during the intervening period, the decline in per capita income was minor because of a large increase in remittances from Diaspora Somalis, which largely offset the sharp drop in per capita output. Per capita income at US\$226 was somewhat lower than in Tanzania (US\$280), but higher than in Eritrea (US\$190) and in Ethiopia (US\$100). The rough figures available for the incidence of poverty, life expectancy and child malnutrition show similar patterns somewhat better than the poorest countries in Africa and not much different than they were in the pre-war period.

Throughout the two decades, with the lack of effective national governance, Somalia maintained a healthy informal economy, largely based on livestock, remittance/money transfer companies, and telecommunications. Agriculture is the

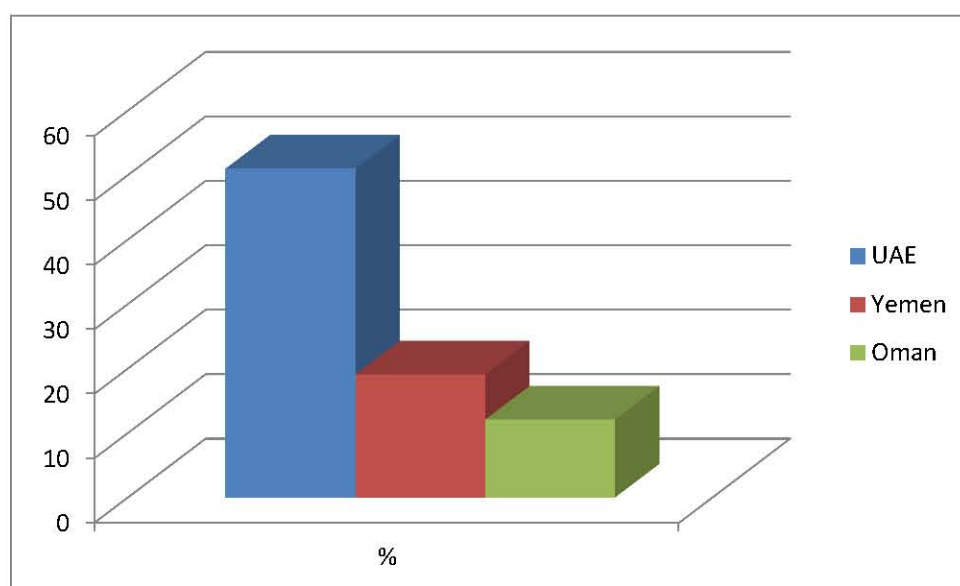
⁷ Sources: World Bank, UNDP, CIA and CBS estimates.

most important sector with livestock roughly accounting for about 59.3% of GDP and more than 50% of export earnings; followed by services sector with 33.5% and manufacturing 7.3%.

The structure of the economy has drastically changed during the past two decades. In fact, unlike the 1970s and 1980s, when most of the output of a small manufacturing sector and many services were provided by the public sector, virtually all industrial production, services provision, and trade today are firmly in the hands of the private sector. There has been and there continues to be significant private investments in commercial ventures.

Somalia's export partners included United Arab Emirates with 51%, Yemen 19.1% and Oman with 12.9%. Total exports were estimated at US\$ 515.8 million in 2010 compared to US\$300 million estimated in 2006.

FIGURE 2: 2010 SOMALIA'S EXPORTS PARTNERS



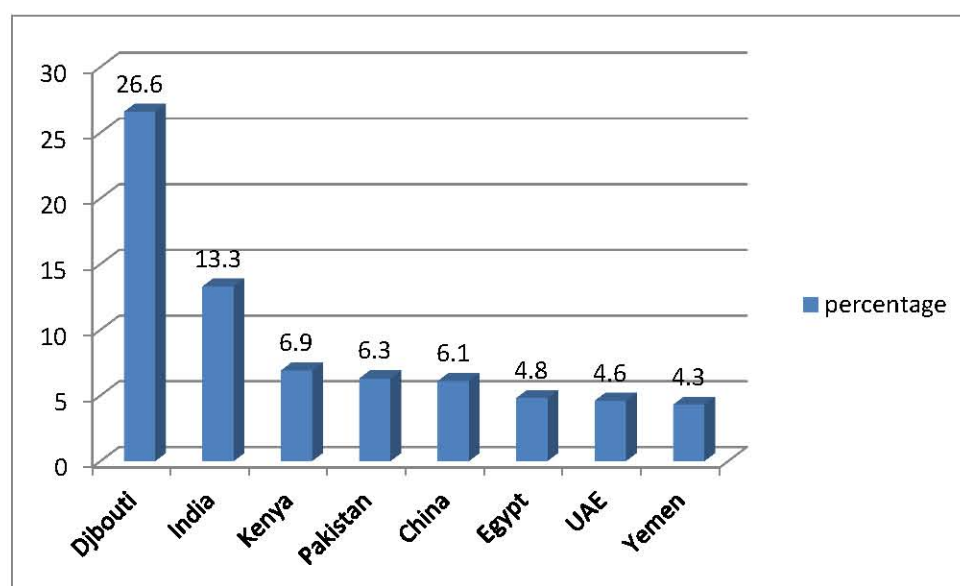
Import partners included Djibouti with 26.6%, India 13.6% Kenya 6.9%, Pakistan 6.3%, China 6.1%, Egypt 4.8%, UAE 4.6% and Yemen 4.3%.⁸ Total imports for 2010 are estimated to be US\$1.263 billion compared to US\$798 million in 2006.

Somalia, in recent years, became a major supplier of camel and charcoal. Sugar, pasta and electronics make their way to large parts of Eastern Africa imported from across the world through Somalia. Trade was facilitated by three main factors:

1. The growth in remittances, which managed to stabilize the Somali Shilling (without the central government);
2. The growth in the telecommunications sector, which made it possible for accurate and timely information to reach remote areas in little time; and
3. The growth in remittance companies, which did away with the need to transport large quantities of cash cross-border.

⁸ These estimates are for 2011.

FIGURE 3: SOMALIA'S IMPORT PARTNERS 2010



The combination of these and other factors resulted in deep domestic, cross-border, and international market integration despite poor security conditions in and around Somalia. Somalia became a de facto duty free zone and an important part of a trade network spanning from Dubai – a critical supply and finance center for Somali businesses – to Ethiopia, Kenya, and their neighbors. The potential of expanding trade, both domestic and cross-border, is immense but it would require the development and establishment of commercial banks and other financial institutions. This would lead to further regional integration and promote foreign direct investment (FDI) and build trust and confidence in the financial institutions of the country.

5. MONETARY POLICY MANAGEMENT

PRICE FLUCTUATIONS AND CONSUMER PRICE INDEX CHANGES⁹

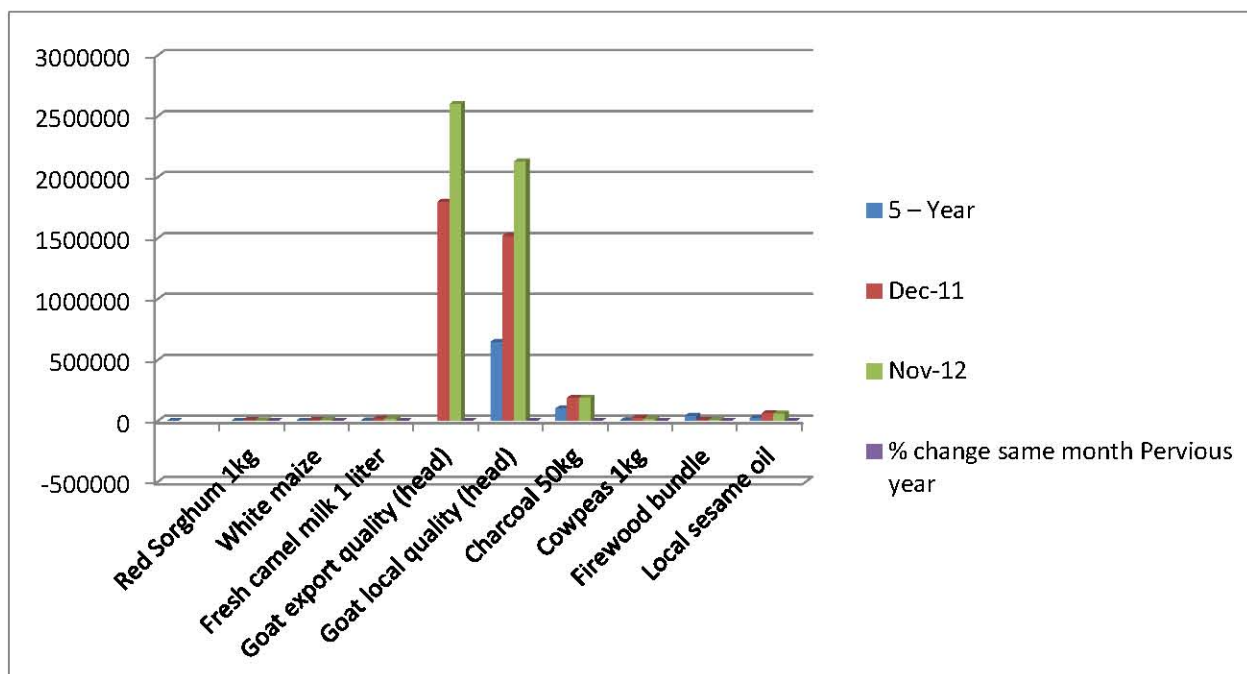
Inflation in 2012 remained subdued and the trend declined for several reasons. The declining inflation can be explained by improved domestic food production and a declining exchange rate. The drop in the Consumer Price Index (CPI) was largely driven by cereal prices (see Table 3).

Local grain prices were mixed – decreased in some regions and increased in others. Various factors, including good Deyr 2012 crop production, cereal trade flows to deficit areas, reduced prices of imported food and humanitarian food supply have had an impact on cereal prices when compared to a year ago. Livestock prices were observed to have remained stable for a certain period of 2012 and then tended to

⁹ Source: www.fsnau.org/ids.

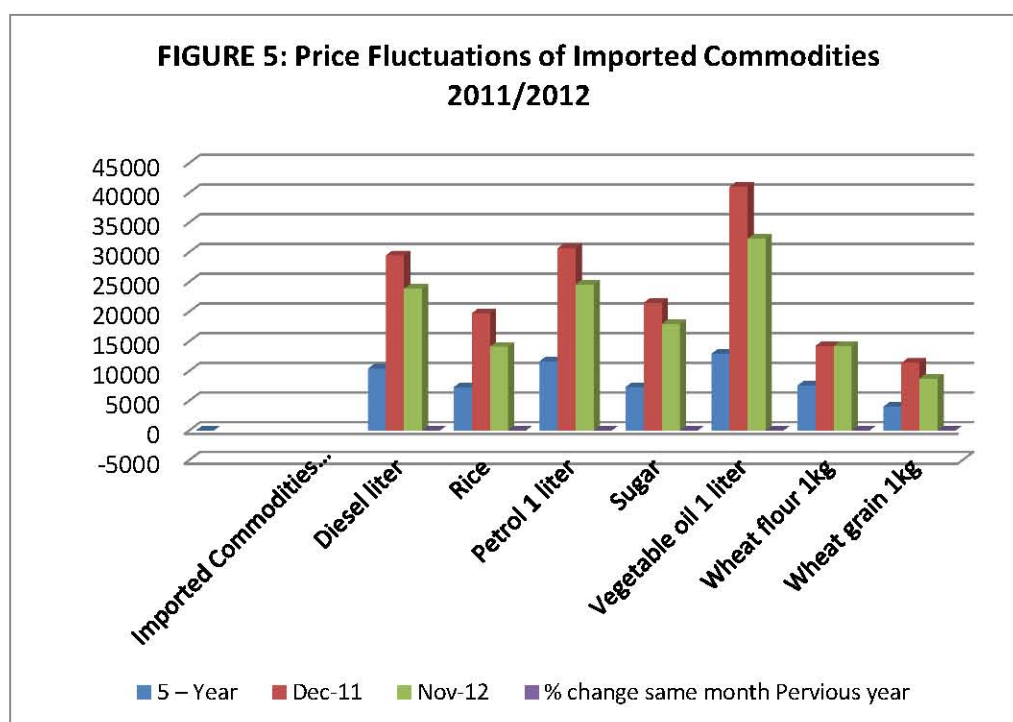
decline due to reduced demand following the end of Hajj (Muslim pilgrimage) (see Table 3).

FIGURE 4: PRICE FLUCTUATIONS OF CEREAL, LIVESTOCK AND OTHER PRODUCTS



In general, livestock prices were observed to be significantly higher than a year ago in all markets where the information was collected as a result of improved physical livestock conditions and high demand from on-going restocking activities. On the other hand, prices of imported commodities declined slightly in 2012. Compared to the same period last year, imported commodities prices are significantly lower (see Figure 5).

FIGURE 5: PRICE FLUCTUATIONS OF IMPORTED COMMODITIES 2011/2012



The decline in prices of imported goods was mainly attributed to the appreciation of the Somali Shilling and improved port operational capacity, including processing and clearance of imported goods at the port and the port's improved security and humanitarian assistance.

Crude oil prices in Dubai, one of the main sources of Somalia's oil imports, remained relatively stable in early December but "edged higher as 2012 drew to a close," posting an average of US\$ 107. According to the monthly Oil Market report (January 2013), the price appreciation extended into early January and this is mainly due to seasonally stronger winter demand and persistent geopolitical concerns in key producing countries. The quotations are stable when compared to December 2011 levels.

The Food Security and Nutrition Analysis Unit¹⁰ estimated that overall 12-month inflation decreased by around 20% during the financial year 2012. This trend is expected to continue in 2013 and more due to improved security and incoming investments from Diaspora Somalis and others.

¹⁰ This data is available online on www.fsanu.org/ids.

Table 3: Price Fluctuations in Banadir Region

Indicator	5 – Year Average (2003-07)	Dec-11	Nov-12	% change same month Pervious year
Imported Commodities Prices				
Diesel liter	10,390	29,458	23,833	-19
Rice	7,275	19,729	14,083	-29
Petrol 1 liter	11,650	30,667	24,542	-22
Sugar	7,291	21,475	17,854	-19
Vegetable oil 1 liter	12,916	41,000	32,250	-20
Wheat flour 1kg	7,541	14,229	14,167	-5
Wheat grain 1kg	4,000	11,375	8,733	-27
Cereal Prices				
Red Sorghum 1kg	2,165	9,775	5,275	-49
White maize	2,835	8,652	7,239	-26
Livestock and Livestock Products Prices				
Camel local quality (head)	6,400,000	13,000,000	-	-
Cattle local quality (head)	3,266,666	3,000,000	-	-
Fresh camel milk 1 liter	4,660	20,396	20,208	-2
Goat export quality (head)		1,800,000	2,600,000	47
Goat local quality (head)	650,000	1,518,750	2,131,250	51
Other essential Items				
Charcoal 50kg	102,000	191,458	190,542	2
Cowpeas 1kg	5,410	28,507	19,688	-35
Unskilled labor	61,875	104,250	110,000	8
Firewood bundle	43,350	7,667	7,800	3
Local sesame oil	23,450	62,542	60,625	-2
Construction Material				
Cement 50kg		190,873	164,225	-13
Cooking pot aluminum 7 liter		322,063	272,222	-17
Galvanized iron sheet ga 26		98,647	82,675	-15
Hollow concrete block 10cmx20cmx 40cm		10,250	10,708	6
Non collapsed jerrycan 10 liter		39,833	39,056	5
Plastic tarpaulin 14m x 5m		237,500	245,833	-5
Roofing nails 15kg		524,755	464,958	-9
Timber 2in x 4in x 2ft		135,775	121,542	-14
Woven dry raised blanket 150cm x 200cm		82,500	109,583	31
Terms of Trade				
Labor wage (daily)/Cereal (maize kg)	22	12	15	46
Local goat (head)/Cereal (maize kg)	229	176	294	104
Price Indices				
Consumer Price Index		256	208	-20
Purchasing power Index		0.39	0.48	25

Source: www.fsnau.org/ids

INFLATION OUTLOOK

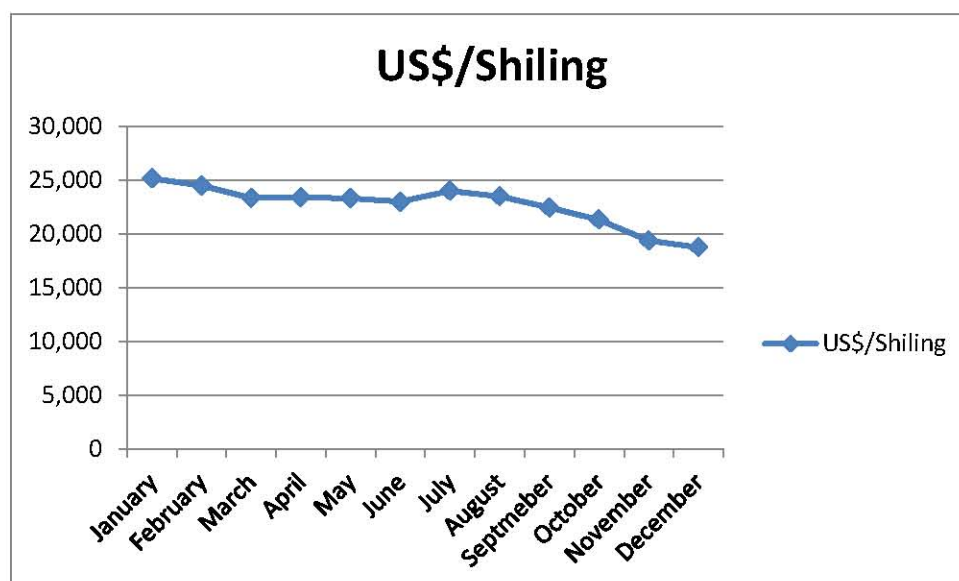
Overall inflation eased during fiscal year 2012 following a decline in several food items and fuel prices. The effects of improved supply side conditions are expected to carry over into fiscal year 2013 and continue to yield lower inflationary pressures. The continued appreciation of Shilling exchange rates is also expected to mitigate against unfavorable price developments of imported commodities.

EXCHANGE RATE

In 2012, the exchange between the Somali Shilling (So.Sh.) and the US\$ continued to appreciate. Compared to the same month a year ago, the Somali Shilling gained considerable value against the US\$. The gain of the Somali Shilling is attributed to increased dollar inflows through humanitarian interventions, Hajj, livestock exports and intensified investments in infrastructure rebuilding and reconstruction in Mogadishu; increased port functioning, improved security and emerging economic and business opportunities, particularly in the capital city.

The large influx of US dollars into Somalia in 2012, which include remittances from overseas, foreign direct investment, income from overseas livestock sales and humanitarian and development programs were the main reasons behind the Shilling's appreciation. The Somali Shilling appreciated by 34% during the year 2012 (see Figure 6 below)

FIGURE 6: EXCHANGE RATES US\$ SOMALI SHILLING JANUARY – DECEMBER 2012



PURCHASING POWER OF SOMALI SHILLING

The appreciation of the Somali Shilling by 34% during the 12-month period of 2012 meant that, by December 2012, families were receiving just 66% of the quantity of local currency that they had received at the beginning of the year. Clearly, a reduction in the quantity of Shillings that a household receives for their dollars has a negative impact on purchasing power, though as discussed above, the strengthening of the Somali Shilling was mitigated by the fall in food prices and other non-food items.

MONETARY POLICY FOR FISCAL YEAR 2012

In 2012, the Central Bank of Somalia had not yet resumed monetary policy formulation, which was disrupted by the country's various conflicts. Before these policies are formed, the Central Bank awaits the appointment of its Board of Directors and the installment of a Monetary Policy Committee. It is this committee's principal responsibility to design the Central Bank's monetary policies.

Furthermore, monetary policy formulation is complicated by the limited availability of information on currency circulation values and the government's foreign currency stock. Another consideration is the development of a more sophisticated and modern commercial banking system, without which important monetary policy strategies, such as limiting domestic currency circulation, are not possible or severely handicapped.

FINANCIAL SYSTEM

Before the civil conflict, Somalia's formal financial sector was composed of the Central Bank of Somalia, Commercial and Savings Bank of Somalia, Somali Commercial Bank, Cooperative Bank of Somalia, Somali Development Bank and the State Insurance Company of Somalia. However, at present, the financial sector is composed of the Central Bank of Somalia, which is not yet fully operational, Somali remittance companies and some micro-finance institutions (as pilot projects in North-Western and North-Eastern regions).

Remittance companies are the only financial services providers in the country for the majority of households and for the entire private sector. Due to the prolonged civil war, there are no commercial banks registered and operational in Somalia; however, some regional banks are in discussion with the Central Bank and Somali remittance companies with regard to joint ventures. In addition, local Somali business persons are exploring the possibilities of launching commercial banks that may provide service to poor Somalis. Remittance companies supported by spin-off activities in the telecommunications sector sprang up as the main medium for hard currency

movements to and from the country, as well as an instrument for trade and commerce in Somalia and abroad.

DEVELOPMENT OF A PAYMENTS SYSTEM

The Central of Bank of Somalia will be developing a modern national payments system, which is critical to the development of the Somali economy. Such a system will move Somalia from mostly cash transactions to an economy in which electronic transactions are far more common. The prevalence of mobile banking today serves as a starting point in this development. These mobile banking services already allow anyone – including the “unbanked” population – with a mobile phone to send and receive money, provided they have funds in their mobile accounts. Nevertheless, these services do not replace ordinary banking functions, which are severely limited without a payments system. The creation of a payments system is complex and expensive. As such, the Central Bank is seeking assistance from its international partners, including International Financial Institutions, in developing the system.

BANKING SUPERVISION

Over the last two decades, there have been significant developments in the financial services sector that have changed the nature of the risks faced by, and risk management practices of, financial institutions in Somalia. Formal banking systems went out of business and an informal banking system took over. Hawalas entered into the market and began offering not only money transfers but also some banking operations such as deposit and savings accounts. They also began offering some loans and payment systems for imports/exports and domestic trades. Their operations are becoming more sophisticated, as they have expanded into running global operations. This has caused risks to become more systemic and certain hawalas to have experienced multiple and severe stresses to their solvency and liquidity as a result of their inability to fully demonstrate compliance with international standards and regulations. This has exposed them to, and they have sometimes been subject to, legal sanctions worldwide.

In response, the Central Bank is preparing to develop financial institution supervision strategies that will adequately address the service offerings and practices of Somalia’s network of hawalas. By adopting risk-based supervision, in contrast to the compliance-based supervision approach used by some neighboring countries, CBS aims to adopt a system of guidelines and regulations that can better accommodate Somalia’s hawala services. Risk-based supervision steers away from a “one size fits all” approach; instead, when enforcing prudential regulations, this approach considers a number of factors rather than requiring one set of rules and regulations for all financial institutions. These factors may include risk level and institution size

and type. This gives the Central Bank more flexibility in addressing and supervising Somalia's financial services industry and adjusting strategies when necessary.

6. FISCAL POLICY MANAGEMENT

The government budgetary operation for the fiscal year 2012 resulted in a deficit of over US\$35 million. This was due to an optimistic and ambitious budget that did not reflect the reality on the ground. These included security conditions, its budget, and limited support from development partners for non-military government programs. Little of this budget has been implemented. Table 4, below, shows variances between estimated revenue and expenditure were significant and this can be interpreted as poor budget formulation, processes execution, and weak revenue management.

Table 4: Government Revenue and Expenditure 2012 in US\$.

	2011 Budget	2011 Actual	2012 Budget	2012 Actual
	US\$	US\$	US\$	US\$
Total Domestic Revenue	29,908,900	35,164,560	55,515,000	30,164,734
Tax Revenue	26,978,900	2,106	47,113,000	3,717,698
Non Tax Revenue	2,930,000	35,162,454	8,402,000	26,447,036
Domestic Loans	-	-	-	-
Total External Grants	68,660,000	20,318,437	58,000,000	4,905,586
Bilateral	50,000,000	20,318,437	52,000,000	4,905,586
Multilateral	18,660,000	-	6,000,000	-
Total Revenue	98,568,900	55,482,997	113,515,000	35,070,320
Total Recurrent Expenditure	66,568,900	55,436,028	114,828,545	35,089,385
Administration and General Services	56,195,000	38,910,021	98,661,000	17,393,427
Security Services and Contingencies	3,680,900	16,526,007	4,200,000	14,610,831
Economic Services	4,063,000	-	7,528,860	2,360,467
Social Services	2,630,000	-	4,438,685	724,660
Total Capital Expenditure	32,000,000	-	48,300,000	-
Administration and General Services	5,765,500	-	12,400,000	-
Security Services and Contingencies	-	-	-	-
Economic Services	13,788,080	-	19,900,000	-
Social Services	12,446,420	-	16,000,000	-
Total Expenditure	98,568,900	55,436,028	163,128,545	35,089,385
Financing Gap: Surplus / (Deficit)	-	46,969	(49,613,545)	(19,065)

Source: Ministry of Finance, Volume I, the Budget Framework 2012

GOVERNMENT REVENUE

The government has limited sources to generate revenue needed to pay for regular state functions, like maintaining peace and social order and providing for essential economic and social services. Currently, the only sources of state receipts are from customs duties levied on goods imported from overseas through Mogadishu's air and sea ports and some contributions from a few services rendering companies; telecommunications and money transfer companies, and large hotels. Despite certain irregularities with regard to revenue collections, the government has decided to levy some charges on commercial goods and services. Revenue collection practices offer a good opportunity for forecasting state revenue.

However, revenue collection remains inadequate. The proposed target measures in the 2012 budget have not been achieved as proposed. It is worth noting that the 2012 budget was not approved by the Parliament, except for the last quarter of the year. This was the mini-budget formulated by the new government submitted and approved by the Parliament. Comparing the budgeted and the estimated actual receipts, the domestic revenue mobilization is shown in table 4.

The performance of government revenue in 2012 was dismal; as shown in table 4, actual revenue achieved only 54% of the targeted budget. Overall, the achievement of tax revenue was very poor. This was explained by the fact that tax administration was very weak and had neither the capacity to implement tax laws nor to collect taxes. Furthermore, volatile security also contributed to poor tax collection.

7. PUBLIC DEBT

There are no reliable, recent statistics for Somalia's public debt. However, historical numbers are useful for limited analysis, particularly because they demonstrate Somalia's poor Public Financial Management over a prolonged period of time. Conflicts in the country exasperated the government's ability to prudently handle debt.

By 1989, Somalia's public and publicly guaranteed debt was estimated to be \$1.7 billion USD, which was almost 200% of the value of the country's GDP. To offer another point of reference, 1989's public and publicly guaranteed debt was almost thirty times Somalia's merchandise exports.

Table 5: Stock of Public and Publicly Guaranteed External Debt (in US\$)

Creditor	Nominal Stock (\$million)					NPV of total debt (\$ million)
	Total		Arrears			
	Stock	Percentage	Principal	Interest	Total	
1. Multilateral	1,273	39.7	479	344	822	1,118
World Bank – IDA	491	15.3	81	46	127	353
IMF	345	10.8	174	171	345	353
AfDB Group	126	3.9	37	21	57	102
Others	310	9.7	187	106	293	318
2. Bilateral & Commercial	1,935	60.3	924	833	1,757	1,861
Paris Club Creditors	1,472	45.9	573	740	1,314	1,398
Non Paris & Commercial creditors	462	14.4	351	93	444	463
Total Debt (1+2)	3,207	100.0	1,403	1,177	2,580	2,979

Source: World Bank (2006)

For the last two decades, Somalia did not borrow additional funds, but it also did not service its outstanding public debt. Its debt levels, along with political instability and poor security conditions, hindered the country's recovery efforts. As of 2006, Somalia's external debt was then (public and publicly guaranteed) estimated at US\$ 3.2 billion. Of this, 40% was owed to multilateral creditors (including interest charges owed to the IMF), 46% to Paris Club bilateral creditors, and 14% to non-Paris Club bilateral and commercial creditors. The net present value of the total stock was estimated in 2005 to be 2.9 billion.

With the African Development Bank Group, Somalia has been under sanctions since October 1990. By 31 December 2009, Somalia had accumulated loan repayment arrears of about UA51.1 million over a period of 20 years.

Table 6: Arrears to the AfDB Group on 31 December 2009 (in thousand UAs)

	Total	Principal	Charges
ADF	37,183.7	27,832.5	9,351.2
ADB	12,455.4	4,052.6	8,402.8
NTF	1,435.7	611.8	823.9
Total	51,074.8	32,496.9	18,577.9

Source: African Development Bank (2011)

The World Bank and the IMF are also owed substantial amounts. On 30th November 2009, total overdue amount to the IMF by Somalia was SDR229.7 (SDR112 in principal and SDR117.7 million in charges and interest).

It will be challenging but necessary for the current government of Somalia, in contrast with governments of the last two decades, to settle its debt obligations and mark a significant departure from unsustainable fiscal policies. Clearing its obligations will need to involve close cooperation between the government and its creditors.

8. EXTERNAL RELATIONS

INTERNATIONAL MONETARY FUND

After 22 years of suspension, Somalia has been finally re-admitted to the International Monetary Fund. The move opens the door for the IMF to offer Somalia technical assistance and policy advice. However, it will take time for the IMF to allow Somalia to borrow IMF funds. The process requires that Somalia first repays \$352

million in arrears that it owes to the Fund. This will require negotiations with the IMF to enable Somalia, through bridge financing, to clear its arrears and to undertake a new policy reform program to be supported by the World Bank, AfDB and development partners.

UNITED NATIONS DEVELOPMENT PROGRAMME

UNDP has been supporting the Central Bank of Somalia since 2006. To assist the Central Bank in carrying out its considerable national responsibilities, vested by both the old and the new Central Bank Acts, it provided both technical and financial assistance to the Central Bank.

Furthermore, UNDP financed a study to review banking processes and develop a banking vision, in order to enhance economic and financial governance, implement a sound monetary policy finance management system, which is essential for Somalia's recovery and macroeconomic stability. Currently, it is providing more support to recruit Somali banking experts from the Diaspora to assist CBS to function according to the policy and structure as established in Central Bank act of 2011.

AFRICAN DEVELOPMENT BANK GROUP

In 2012, the African Development Bank provided substantial support to the Central Bank to develop the Central Bank Act and the Financial Institutions Act. These two Acts were developed by local and international experts through a consultative process, which involved domestic and international stakeholders. The Acts were taken through all the steps required by the Somali legal process. First, they were drafted and reviewed by a team of experts of the Central Bank, Ministry of Finance and the Attorney General, then submitted to the Council of Ministers, and through the Minister of Finance, to the Parliament. After discussion and some modifications made by the Parliament, the Acts were approved. The Central Bank Act was approved in 2011 and the Financial Institutions Act was approved in 2012.

WORLD BANK

The World Bank has been implementing several programs, such as LICUS, which has the objective to assist the government to improve inclusiveness, transparency and accountability of Public Financial Management at all levels of government. Its objectives also include modernizing customs services and developing regulatory frameworks for monetary management and banking sector (Somaliland and Puntland). The World Bank also supported Public Financial Management self-assessments for the Ministry of Finance, the Central Bank, and integrity institutions. In addition, The New Deal, a World Bank initiative, considers that transitioning out of fragility is long, political work that requires country leadership and ownership. Processes of political dialogue have often failed due to lack of trust, inclusiveness,


and leadership. International partners can often bypass national interests and actors, providing aid in overly technocratic ways that underestimate the importance of harmonising with the national and local context, and support short-term results at the expense of medium to long-term sustainable results brought about by building capacity and systems. A New Deal for engagement in fragile states is necessary.

CENTRAL BANK OF TURKEY

The Central Bank of Turkey will assist the Central Bank of Somalia in strengthening its institutional capacity to formulate monetary policies and promote corporate good governance. The Central Bank of Turkey will also provide experts and secondment of the CBS staff at its head office in Ankara.

CENTRAL BANK OF KENYA

The Central Bank of Kenya will provide training for a group of Central Bank of Somalia staff members at the Kenya School of Monetary Studies in Nairobi. This will be followed by practical workplace training for the group at the Central Bank of Kenya's headquarters.



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